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March 28, 2006

BY HAND

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



Re: Ex Parte No. 575
Review of Rail Access and Competition Issues -- Renewed Petition
of the Western Coal Traffic League

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are an original and ten copies of the Reply Comments of Union Pacific Railroad Company. Also enclosed is a diskette with a copy of the filing in Word format.

As provided in the Board's February 1, 2006 decision, we are not serving this submission on the other participants in this proceeding. Any participant desiring a hard copy should contact the undersigned.

Kindly acknowledge receipt and filing of this material by date-stamping the enclosed extra copy of the filing and returning it to our messenger.

Sincerely,

Michael L. Rosenthal

Enclosures

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BEFORE THE
SURFACE TRANSPORTATION BOARD



STB Ex Parte No. 575

REVIEW OF RAIL ACCESS AND COMPETITION ISSUES – RENEWED PETITION
OF THE WESTERN COAL TRAFFIC LEAGUE

REPLY COMMENTS OF UNION PACIFIC RAILROAD COMPANY

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Union Pacific Railroad Company (“UP”) has subscribed to the reply comments submitted by the Association of American Railroads. UP is submitting these comments because Western Coal Traffic League (“WCTL”) and its supporters have mischaracterized the nature of certain specific transactions involving UP (or its predecessors) in order to support an unjustified change in the Board’s policies regarding interchange commitments in agreements between larger railroads and shortlines. These comments correct those mischaracterizations so that the Board will have an accurate record upon which to dispose of WCTL’s Renewed Petition.

WCTL and its supporters reveal in their comments that they are laboring under significant misconceptions about the nature of the interchange commitments they are attacking, at least with respect to those contained in agreements involving shortlines that have been spun-off from UP. WCTL and its supporters wrongly believe that these provisions reduce competitive options for shippers, that they overcompensate the larger railroad for the spin-off transaction, and that they could be voided without undermining the transaction.

In this reply, we attempt to correct these misconceptions by focusing on two UP-related transactions that have been discussed in this proceeding: (1) UP’s lease agreement with

Missouri & Northern Arkansas Railroad ("MNA"), which has been called the "poster child for the excessive and overreaching paper barriers,"¹ and (2) UP's sale of its line between Vigus and Pleasant Hill, Missouri, to Missouri Central Railroad ("MCRR").²

These reply comments are supported by the accompanying reply verified statements of Warren C. Wilson, Senior Director-Rail Line Planning for UP ("Wilson RVS"), and Rick Gough, UP's Senior Business Director Energy for UP ("Gough RVS"), and by Mr. Wilson's opening statement on behalf of UP ("UP Comments").

I. UNION PACIFIC'S INTERCHANGE COMMITMENTS HAVE NOT REDUCED SHIPPERS' COMPETITIVE OPTIONS.

The type of interchange commitments at issue in this proceeding do not reduce shippers' competitive options. UP negotiates them only when shortlines operate lines formerly owned by UP or its predecessors. (UP Comments at 8.) WCTL and its supporters cannot seriously contend that shippers located on such shortlines have had their competitive options reduced by interchange commitments, because those shippers always had to route their traffic over UP. (*Id.*)³ The MNA and MCRR transactions are clear examples of spin-offs that did not reduce shippers' competitive options. (Gough RVS at 1-2; Wilson RVS at 8-9.)

¹ Comments of Entergy Services, Inc ("Entergy") at 4. The MNA transaction is discussed in comments filed by WCTL; Entergy, including the verified statement of Entergy's Manager-Coal Supply, Jeffrey G. Herndon ("Herndon VS"); and Arkansas Electric Cooperative Corporation ("AECC").

² The MCRR transaction is discussed in comments filed by Ameren Energy Fuels and Services Company ("Ameren").

We also briefly discuss the agreement governing Southern Pacific's sale of three rail lines to Central Oregon & Pacific Railroad ("COPR") because WCTL mentions the transaction in its Comments. (WCTL Comments at 15-16.)

³ In fact, WCTL essentially concedes that it is actually seeking to increase competitive options rather than prevent a reduction in competition when it argues that the Board should evaluate interchange commitments using "the Board's new competition-enhancing policy" (continued...)

Nor do interchange commitments result in what WCTL calls the “artificial preservation of monopoly control.” (WCTL Comments at 20.) Most spin-offs never would have occurred if the parties had not been allowed to negotiate such commitments, and shippers using the affected lines thus never had the prospect of obtaining additional competitive options. (UP Comments at 4, 11-12.)⁴ The MNA and MCRR transactions are clear examples of spin-offs that never would have occurred without interchange commitments. (Wilson RVS at 7-8.)

A. The MNA Transaction Did Not Reduce Shippers’ Competitive Options.

The MNA lease had no harmful effect on competition. UP would never have leased its line to Entergy’s plant in Independence, Arkansas, if it could not have preserved the revenues associated with providing service to that plant. (Wilson RVS at 7.) As WCTL recognizes, the MNA lease and interchange commitments allow UP to preserve its revenues while reducing its operating costs. (WCTL Comments at 19.)⁵ WCTL asserts that this type of transaction, as opposed to one that saves a rail line from abandonment, “presents the greatest

adopted in merger cases, under which carriers must explain how a transaction “would result in new or more effective competition, not simply maintain an equivalent to the pre-merger status quo.” (WCTL Comments at 20-21.)

⁴ The American Short Line and Regional Railroad Association (“ASLRRA”) agrees that most spin-offs would not have occurred but for interchange commitments: “[W]ithout the boundaries and predictability that paper barriers create for divesting class I carriers, a large number of [ASLRRA’s] members would never have been created in the first place,” because large carriers “are less likely to choose to sell or lease the lines if it means handing over existing customers to competitors.” (ASLRRA Comments at 3.)

⁵ The reciprocal commitments under the MNA lease also allow UP to comply with its contractual obligations to provide transportation services under its long-term contract with Entergy. (See, e.g., MNA Lease §§ 3.01-3.04, 6.01-6.06, 15.01.)

cause of concern to shippers.” (*Id.*) But WCTL never explains why shippers should have any concern when the only alternative would have been continued service from UP.⁶

AECC and Entergy also try but fail to identify harms from the MNA transaction. First, they are wrong when they claim that the MNA interchange commitments “increase rates by obstructing alternative routings” to Independence. (AECC Comments at 4; *see also* Entergy Comments at 4-5 & Herndon VS at 9.) The MNA lease and interchange commitments did not eliminate any alternative competitive route, and thus UP’s rates to Independence would not be lower if UP had never entered into the MNA lease. (Gough RVS at 1-2; UP Comments at 11.)

Second, AECC and Entergy are wrong when they claim that the MNA commitments “make it essentially impossible to rely on another carrier to supply PRB coal for Independence when service problems occur on UP.” (AECC Comments at 6; *see also* Entergy Comments at 4 & Herndon VS at 7-8.) In fact, they would be in the exact same position if UP had never leased the lines to MNA. (Gough RVS at 1-2.) Moreover, as Mr. Gough explains, UP has tried to work with Entergy to mitigate the effects of service problems. During UP’s 1997-1998 service problems, UP told Entergy that it would allow BNSF Railway⁷ to handle Entergy trains via an interchange with MNA on a temporary detour basis, but Entergy never took advantage of this offer. (*Id.* at 2) UP is not aware of any other time that Entergy has asked to use a BNSF-MNA routing to receive PRB coal that UP was unable to deliver. (*Id.* at 2-3.)

⁶ WCTL never claims that UP would have leased or sold the lines without interchange commitments. To the contrary, WCTL asserts that the MNA lease reflects a “fundamental change in the nature of paper barriers,” in that railroads are using interchange commitments where “lines still have profitable traffic for their Class I owners and without some sort of paper barrier or access restriction, many of those lines would not, could not be sold due to revenue or contribution risk.” (WCTL Comments at 18 (quoting Ex Parte No. 658, Transcript dated Oct. 19, 2005, Testimony of J. Reilly McCarren, Rail Industry Working Group at 334-35).)

⁷ At that time, BNSF Railway was called The Burlington Northern & Santa Fe Railway.

Third, AECC and Entergy are wrong when they claim that the MNA commitments have precluded efforts “to diversify fuel supply” to Independence. (AECC Comments at 6; *see also* Entergy Comments at 4 & Herndon VS at 8.) The MNA lease has not affected any such efforts. AECC and Entergy misinterpret the MNA lease when they assert that UP could “preempt” Entergy’s efforts to source coal from MNA-served locations in western Missouri. (AECC Comments at 6; Entergy Comments at 4 & Herndon VS at 8.) The lease does not restrict MNA’s ability to handle local traffic. (MNA Lease § 4.02.)⁸ The provision at issue protects Entergy by allowing UP to resume service to the Independence plant without substantial delay if MNA service fell to unacceptable levels. (*Id.*) Moreover, UP has cooperated with Entergy’s efforts to explore sourcing options. As AECC acknowledges, UP cooperated in recent movements of substitute Colorado coal to the Independence plant. (AECC Comments at 7; *see also* Gough RVS at 3.) Entergy mentions the possibility of moving import coal from the Gulf. (Herndon VS at 8.) However, it neglects to mention that UP cooperated with Entergy’s efforts to move import coal from the Gulf Coast to Independence by offering to establish a rate and interchange point for coal that would have moved from a Gulf Coast facility located on Canadian National. (Gough RVS at 3.) UP remains willing to discuss possible waivers of the MNA interchange commitments or cooperative efforts with other railroads to establish rates and interchange points for coal that UP cannot supply. (*Id.*)

B. The MCRR Transaction Did Not Reduce Shippers’ Competitive Options.

The MCRR transaction involved different circumstances, but it also had no harmful effect on competition. As Ameren acknowledges, the MCRR line was “heading for

⁸ The MNA lease is attached as Exhibit 1 to Entergy’s Opening Comments.

abandonment.” (Ameren Comments at 7.) If UP had sold the line without any restriction, the buyer could have used the line to compete with UP to offer service to Ameren’s plant at Labadie, Missouri. (Wilson RVS at 7-8.)⁹ However, there were no buyers willing to compensate UP for that right. Indeed, in 1995, UP offered to sell the line to BNSF or Ameren to address “2-to-1” effects of the UP/SP merger on the Labadie plant, but they both rejected the offer. (*Id.* at 9.) MCRR was able to acquire the line at a greatly reduced price (a price reflecting the line’s net liquidation value) and save the line from abandonment only because the parties agreed that MCRR would not obtain access to Labadie. (*Id.* at 7-8, 11.) Ameren is thus no worse off than if UP had not sold the line with the restriction.¹⁰

WCTL asserts that, with respect to lines slated for abandonment, “there is every reason to expect that a short line carrier would be able to secure sufficient financing to purchase [a] line for its net liquidation value.” (WCTL Comments at 22.) However, MCRR’s line would have been worth substantially more than net liquidation value because it potentially provided access to Labadie. (Wilson RVS at 8, 11.) Moreover, as Ameren acknowledges, MCRR was unable to raise even a net liquidation value purchase price until Ameren “stepped in as a last option financier.” (Ameren Comments at 6-7.)

⁹ The MCRR transaction did not involve a typical interchange commitment because it did not involve a commitment or incentive to interchange traffic with UP. Instead, the transaction contains a restriction that prevents MCRR from serving Labadie. (Wilson RVS at 8.)

¹⁰ In fact, Ameren already has two-carrier service at Labadie. After declining the opportunity to purchase unrestricted access over the line that was ultimately sold to MCRR, Ameren gained direct access to BNSF under the “2-to-1” condition in the UP/SP merger. *See Union Pac. Corp., Union Pac. R.R., & Mo. Pac. R.R. – Control & Merger – S. Pac. Rail Corp., S. Pac. Transp. Co., St. Louis Sw. Ry., SPCSL Corp., & Denver & Rio Grande W.R.R.*, STB Finance Docket No. 32760, Decision No. 89 (STB served June 1, 2000). This gave Ameren single-line access to two railroads that can originate PRB coal. Ameren complains that BNSF has not moved any significant amount of coal to Labadie because BNSF’s rates are not lower than UP’s, but that has nothing to do with the MCRR line sale. (Wilson RVS at 11.)

In their efforts to condemn the actions of larger railroads, WCTL and its supporters simply ignore the challenges facing shortlines. As ASLRRRA explains, many shortlines “are marginally capitalized or worse, and in only a few instances have ready access to Wall Street capital markets.” (ASLRRRA Comments at 4.) By agreeing to accept less cash up front in exchange for interchange traffic, UP makes it easier for shortlines to acquire lines, allows them to avoid debt service payments that would have to be recouped in the rates charged to their shippers, and allows them spend more of their resources on maintaining and upgrading equipment and facilities in order to improve service and attract new traffic. (UP Comments at 12, 17-18; Wilson RVS at 2.)

C. Spin-Offs Create Significant Pro-Competitive Benefits For Shippers.

WCTL and its supporters fail to credit fully the benefits created by spin-offs that would be lost if carriers could not negotiate interchange commitments. The benefits of saving lines from abandonment are obvious. Shippers also benefit, however, from spin-offs that large carriers undertake in an effort to reduce operating costs. These transactions usually make rail service more competitive by reducing the costs of providing service and improving service quality. (UP Comments at 8.) Moreover, railroads have passed along the productivity gains from such cost-saving transactions to their competitive and captive customers. *See* STB Office of Economics, Environmental Analysis, and Administration, *Rail Rates Continue Multi-Year Decline* (Dec. 2000) at 2-3.

In addition, UP spin-off transactions often increase competition directly. For example, the MNA lease opens the door to substantial new competition that would not exist but for the spin-off, because UP does not ask MNA to interchange 100 percent of its traffic with UP. The interchange commitment does not cover all of MNA’s traffic, and MNA would still pay no rent if it interchanged only 95 percent of the covered traffic with UP. (MNA Lease §§ 4.01,

4.02.) Entergy characterizes the difference as “miniscule” (Entergy Comments at 3), but a spin-off the size of MNA could interchange approximately 5,000 cars per year – or nearly 100 cars per week – with UP’s competitors and still pay no rent to UP. (Wilson RVS at 6 n.5.)¹¹

II. INTERCHANGE COMMITMENTS DO NOT OVERCOMPENSATE UNION PACIFIC FOR SPIN-OFF TRANSACTIONS WITH SHORTLINES.

The comments submitted by WCTL and its supporters comments reveal that these parties misunderstand the economic structure of UP’s spin-offs and the nature of the relationship between many shortlines and their Class I connections. WCTL and its supporters apparently believe that most interchange commitments are simply substitutes for one-time payments that could readily be converted to a present value, but in many cases, they are part of a long-term, multifaceted relationship rather than just a financing mechanism.

WCTL relies on a statement from Professor Paul S. Dempsey, who assumes that (i) railroads could readily substitute up-front payments for interchange commitments in spin-off transactions; and (ii) larger railroads are over-compensated if interchange commitments remain in place for more than five years. (WCTL Comments, Dempsey VS at 3-4). WCTL and Dempsey are wrong on both counts, at least with respect to the types of interchange commitments that are commonly used by UP.

¹¹ Entergy also complains about the amount of rent that MNA would be required to pay UP if it interchanges less than 95 percent of covered traffic with UP. (Entergy Comments at 3 & Herndon VS at 4-5.) However, Entergy fails to recognize that, although the rental amount may appear large in relation to the value of the traffic to MNA, it actually reflects the value of the entire revenue stream to UP, for which the rent would compensate UP. (Wilson RVS at 3 n.1.) Entergy also fails to consider that, if the interchange provision could be voided (which it cannot), MNA would be obligated to pay the full rental amount. (*Id.* at 4 n.3; MNA Lease § 4.01.)

A. The MNA Transaction Does Not Overcompensate UP.

Most UP spin-offs include interchange commitments that could not readily be replaced by up-front payments. Under the interchange commitments in most UP spin-offs, the shortline pays nothing to use UP's assets if it interchanges most of the traffic generated by the lines to UP. (UP Comments at 5.) The MNA lease is an example of this type of transaction: MNA pays no rent for the leased lines as long as it interchanges at least 95 percent of the traffic covered by its interchange commitment with UP. (*Id.* at 6; MNA Lease § 4.01.) In fact, UP pays MNA a fee to handle the interchange traffic for UP. (Wilson RVS at 4; MNA Lease § 22.01.)

UP's interchange commitment with MNA is not merely an alternative means of financing the lease; it plays a vital role in establishing an on-going business relationship between UP and MNA. (UP Comments at 5.) In this relationship, UP benefits as long as the per-car fee it pays MNA is less than it would cost UP to handle the traffic; MNA benefits as long as the per-car fee it receives from UP is more than its costs to handle the traffic. UP does not require MNA to compensate UP for the value of lost interchange traffic because UP does not lose the income stream as long as MNA continues to interchange the traffic with UP. Under this arrangement, MNA will not compensate UP for the value of an unrestricted sale in five years, or at any point in the future. MNA has never paid UP any rent for the 400 miles of track it has leased from UP since 1992. (UP Comments at 6.)

At times, Entergy appears to understand the nature of UP's relationship with MNA. It says that MNA "operates as a subcontractor for UP by interchanging loaded coal trains with UP . . . , delivering the loaded coal trains to Independence for unloading and returning the

unloaded coal trains . . . for interchange with UP.” (Herndon VS at 3.)¹² At other times, however, Entergy misses the point, criticizing arrangements under which MNA pays no rent because “they are not tied to the volume of traffic interchanged with UP.” (Entergy Comments at 3.)¹³ Entergy also mistakenly asserts that the MNA lease “never expires.” (*Id.* at 4.) In fact, the MNA lease has a 20-year term that expires in 2012. (MNA Lease § 2.01) MNA can elect not to renew the lease if it is not satisfied with either its current cooperative arrangement or the rent it is required to pay if it chose not to interchange traffic with UP. (*Id.* § 2.02.)

B. The MCRR Transaction Does Not Overcompensate UP.

The MCRR transaction is also different from the type of interchange commitment imagined by Professor Dempsey and other supporters of WCTL. As discussed above at page 6, UP structured the transaction so that MCRR could acquire the line without paying the much higher price that would have been required had MCRR wanted access to Labadie. UP sold the line for the net liquidation value, and it does not obtain any on-going payments from MCRR. Thus, MCRR will never compensate UP, much less overcompensate UP, for the value of an unrestricted sale no matter how long it operates the line.

The MCRR transaction is atypical in that it was structured to exclude access to a facility located on the shortline, but it is in some ways similar to spin-offs structured by Chicago

¹² Although “subcontractor” may not be an entirely accurate description, Entergy correctly recognizes that the relationship is in the nature of a cooperative business venture, part of which includes UP payments to MNA for handling loaded coal trains.

¹³ MNA’s obligation to pay rent is triggered by a percentage-based volume requirement rather than a fixed volume requirement, but a percentage-based commitment actually creates less risk for MNA. Percentage-based requirements are very common in rail shipper contracts. They also make sense in the shortline context. A shortline like MNA has more control of its ability to avoid rental payments by interchanging a set percentage of traffic with UP than by interchanging a set number of cars with UP, because it has little control over the total volume of traffic that will be interchanged by UP or generated by on-line customers in any given year.

& North Western (“CNW”). As Mr. Wilson explained in his opening statement, CNW typically dealt with the potential loss of interchange traffic by selling portions of line but granting the shortline only overhead trackage rights on segments with connections to other railroads. (UP Comments at 9.) Because CNW never sold the shortline the ability to interchange traffic as part of the spin-off, it did not need to set the sale price or the trackage rights rate to recover for the loss of interchange traffic. Under these circumstances, as with sales of overhead trackage rights in other types of transactions, the tenant’s payments over the years will never be sufficient to entitle the tenant to unrestricted trackage rights.

C. The COPR Transaction Does Not Overcompensate UP.

WCTL and Professor Dempsey also express unwarranted concern about the type of interchange commitment commonly used by Southern Pacific (“SP”) because they misunderstand the terms of the transactions. They discuss SP’s sale of three lines to COPR under terms that required an up-front payment of \$17 million and payments of at least \$2,700 for each car interchanged to competitors. (WCTL Comments at 15.) They contend that the terms are unreasonable because, “if CORP interchanges 10,000 cars to SP and none to anyone else, SP is satisfied with the \$17 million” but “if COPR interchanges 15,000 cars to SP and 1000 to a competitor, suddenly the ‘purchase price’ shoots up by at least \$2.7 million.” (*Id.* at 16.)

What WCTL and Professor Dempsey apparently fail to recognize is that SP was not “satisfied with the \$17 million” – SP was satisfied with \$17 million plus its share of revenues from traffic that it planned to interchange with COPR. If SP expected to interchange 1,000 cars with COPR but they were interchanged with a competitor, SP would be entitled to compensation for the lost revenues. WCTL and Professor Dempsey never explain why parties should not be allowed to structure spin-offs that account for going concern value by requiring payments for

adversely routed traffic, or why the payments should be presumed to provide sufficient compensation after five years.

Moreover, WCTL and Professor Dempsey fail to consider whether the COPR transaction or similar transactions would have occurred if divesting railroads were required to account for the possibility that spin-offs might not interchange all of their traffic with the larger railroad through high up-front payments rather than interchange commitments.

As Mr. Wilson has explained, interchange commitments are usually essential to make the economics of a spin-off transaction work for both the Class I road and the shortline. (UP Comment at 4.) ASLRRRA makes the same point from the shortline perspective. It states that it “is unrealistic to suggest that . . . the value of [potential] lost business to the divesting carrier can simply be structured into a front end premium on the sales or lease price for the line.” (ASLRRRA Comments at 4.) Shortlines often “are marginally capitalized or worse, and in only a few instances have ready access to Wall Street capital markets.” (*Id.*) They could not obtain the financing required to make large front-end payments, and thus “front loading additional costs to replace [interchange commitments] will necessarily eliminate the ability of many smaller railroad operators to finance the acquisition of the lines at all.” (*Id.*)

D. UP Provides Benefits Through On-Going Relationships With Shortlines.

WCTL and its supporters criticize the long-term nature of many interchange commitments, but they fail to recognize the ongoing nature of the shortline relationship. As Mr. Wilson explained in his opening statement, interchange commitments in spin-offs are typically part of a bundle of provisions which establish an ongoing, cooperative business relationship between UP and the shortline. (UP Comments at 8; *see also* Wilson RVS at 6.)

The UP-MNA relationship provides a good example of the ongoing benefits obtained by shortlines in spin-offs. First, as discussed above, MNA enjoys a revenue stream

from UP for handling traffic over the leased lines without paying a single dollar of rent. Second, as Mr. Wilson has explained, in most of UP's shortline leases, UP markets the shortline routings to offline customers, treats shortline-served points as UP points in its pricing documents, makes arrangements with connecting carriers beyond UP for pricing shortline traffic, and provides shortlines with a wide variety of other support functions, such as equipment supply and interline settlements. (UP Comments at 8.) MNA is no exception. (Wilson RVS at 6.) It is neither surprising nor suspicious that most shortlines prefer to enter into cooperative relationships with UP rather than acquire lines outright and assume these greater responsibilities and higher costs.

III. INTERCHANGE COMMITMENTS CANNOT BE ELIMINATED WITHOUT DISRUPTING THE ENTIRE UNDERLYING TRANSACTION.

WCTL and its supporters do not discuss the implications of eliminating existing interchange commitments, with one exception: Ameren asserts that they could be removed from spin-off agreements "without disrupting the remaining parts of the transaction." (Ameren Comments at 10.) Ameren ignores reality. Voiding existing interchange commitments would entirely undermine the value of most UP spin-offs. That concern is largely irrelevant, however, because the Board is legally prohibited from retroactively removing interchange commitments from consummated spin-offs, and the few legitimate complaints about the potentially effects of interchange commitments that have been raised in this proceeding are addressed in the AAR-ASLRRA Railroad Industry Agreement ("RIA").

A. Interchange Commitments Cannot Practically Be Removed From Consummated Spin-Off Transactions.

The MNA lease provides a typical example of how removing interchange commitments would undermine the entire transaction. As discussed above, the MNA lease is structured so that MNA pays no rent if it interchanges at least 95 percent of its business with UP. The no-rent deal makes sense only because UP does not lose the income stream generated by the

traffic handled by MNA. However, WCTL and its supporters would allow MNA to interchange all or a substantial portion of its traffic with BNSF or Kansas City Southern without paying any rent to UP.¹⁴ In other words, MNA would be able to use UP's property without compensating UP for the value of the assets or the income stream they produce. This would be an untenable situation for UP. Indeed, no rational business would make such a deal.

As Entergy observes, the MNA lease contains several provisions designed to prevent such an unfair situation from arising. (Entergy Comments at 3 & Herndon VS at 5-6.) For example, UP may terminate the lease if "a court or other body" determines that the interchange commitments are "unlawful or otherwise unenforceable." (MNA Lease § 15.01(f).) Entergy criticizes these provisions, but they merely reinforce the point that UP would not have leased the line if it could not have preserved its existing stream of revenue from traffic that would be handled by MNA.¹⁵

The same type of unfairness would arise if interchange commitments were voided in the other types of spin-off transactions discussed above. In the case of MCRR, Ameren wants to give MCRR access to Labadie, even though neither MCRR nor Ameren ever paid for that access. In the case of COPR, COPR could shift traffic to BNSF without compensating UP for lost revenues, even though the parties agreed that part of the compensation for the transaction would be the continued routing of traffic over UP.

¹⁴ As noted above, the actual result of "voiding" the interchange provision would be to require MNA to pay the full rental amount under the lease. See n.11, *supra*.

¹⁵ Entergy also complains that UP granted MNA trackage rights between Pleasant Hill and Kansas City in order to facilitate interchange between UP and MNA, but prohibited MNA from interchanging with other carriers in Kansas City. (Herndon VS at 6.) MNA paid UP only one dollar for the rights. (Wilson RVS at 4 n.2; MNA Lease § 5.05.) Entergy cannot seriously contend that MNA should be allowed to divert UP's coal business to Independence to a BNSF-MNA routing using trackage rights it obtained for one dollar.

As Mr. Wilson observed in his opening statement, UP would seek to terminate most of its existing shortline arrangements if the interchange commitments could be removed. (UP Comments at 7.) However, as we discuss below, the Board could not remove interchange commitments from consummated transactions even if it changed its long-standing policy of allowing interchange commitments.

B. Interchange Commitments Cannot Legally Be Removed From Consummated Spin-Off Transactions.

WCTL and its supporters apparently believe that the Board could adjust the terms of a spin-off transaction in the same way it could modify the terms of transactions in which it has acted affirmatively to preserve or enhance competition and the original terms fail to work, thus resulting in less competition than the agency intended. *Compare Chicago & N.W. Transp. Co. – Construction*, 363 I.C.C. 906, 918 (1981); *Union Pac. Corp., Union Pac. R.R., & Mo. Pac. R.R. – Control & Merger – S. Pac. Rail Corp., S. Pac. Transp. Co., St. Louis Sw. Ry., SPCSL Corp., & Denver & Rio Grande W.R.R. [Oversight]*, STB Finance Docket No. 32760 (Sub-No. 21) (STB served Oct. 27, 1997), at 1. They are incorrect. The two situations are very different. In the case of shortline spin-offs, the agency recognized that there was no reason to take special steps to preserve or enhance competition. The Interstate Commerce Commission carefully considered the competitive impacts of interchange commitments in shortline spin-offs and sanctioned their use several years before UP and its predecessors entered into the MNA, MCRR, and COPR transactions. *See Montana Rail Link, Inc. – Exemption Acquisition & Operation, Certain Lines of Burlington N.R.R.*, ICC Finance Docket No. 31089 (ICC served May 26, 1988); *South Carolina Cent. R.R. – Purchase & Lease – CSX Transp., Inc., Lines in Georgia & Alabama*, ICC Finance Docket No. 31360 (ICC served May 4, 1989). Moreover, shortline spin-offs have not had any adverse competitive effects: as the agency expected, they have either

maintained or increased shippers' pre-transaction competitive options. *See Class Exemption for the Acquisition & Operation of Rail Lines Under 49 U.S.C. § 10901*, 1 I.C.C.2d 810, 817 (1985) ("Proposals under this class exemption generally will maintain the *status quo* and will not change the competitive situation."), *aff'd sub nom. Ill. Commerce Comm. v. ICC*, 817 F.2d 145 (D.C. Cir. 1987).

The Board revisited its policy decision less than a year ago and continued to approve transactions that contained interchange commitments. *See Paducah & Louisville Ry. – Acquisition – CSX Transp., Inc.*, STB Finance Docket No. 34738 (STB served Nov. 18, 2005); *Indiana & Ohio Cent. R.R. – Acquisition & Operation Exemption – CSX Transp., Inc.*, STB Finance Docket No. 34536 (STB served Aug. 23, 2005); *Buckingham Branch R.R. – Lease – CSX Transp., Inc.*, STB Finance Docket No. 34495 (STB served Nov. 5, 2004).

The Board can always revisit its policies, but if it makes the type of dramatic change advocated by WCTL and its supporters, it cannot impose the new policy retroactively to consummated transactions that were structured in reliance on the old policy. The Board has recognized this basic principle of administrative law: "Generally, an agency may not retroactively apply a change in policy to administratively final decisions. *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204 (1988). Thus, we do not reopen administratively final decisions merely because we might handle or decide them differently today." *Canadian Pac. Ltd. – Purchase & Trackage Rights – Delaware & Hudson Ry.*, STB Finance Docket No. 31700 (STB served Mar. 2, 2000) at 4; *see also Heckler v. Cmty. Health Servs. of Crawford County, Inc.*, 467 U.S. 51, 61 n.12 (1984) ("[A]n administrative agency may not apply a new rule retroactively when to do so would unduly intrude upon reasonable reliance interests."); *Railroad Ventures, Inc. – Abandonment Exemption – Between Youngstown, OH, & Darlington, PA*, STB

Docket No. AB-556 (Sub-No. 2X), (STB served Dec. 13, 2004) at 5-6 (denying seller's petition reopen a valuation proceeding where buyers had "reasonably relied on the Board's determination . . . when they chose to proceed to acquire and operate the line" because buyers "could not simply walk away from the deal, as [they] could have when we originally set the price").

UP also joins in the AAR's reply comments, which describe in more detail the reasons the Board could not remove interchange commitments from consummated transactions.

C. The RIA Provides A Mechanism For Shortlines To Pursue Appropriate Waivers Or Alterations Of Interchange Commitments.

Some parties to this proceeding express concerns about interchange commitments that prevent shortlines from improving their economic health by developing new traffic. (*E.g.*, Wheat & Barley Commissions Comments at 6.) UP believes that interchange commitments should not preclude a shortline from turning to another railroad when the carrier with whom it has an interchange commitment does not want to handle new traffic. However, Board action is not needed to address this issue: it is one part of what the RIA waiver process is designed to address. ASLRRRA reports that "the RIA has been an effective private sector framework for the reasonable interpretation and use of paper barriers." (ASLRRRA Comments at 2.) UP has the same view. UP has granted all but a handful of waiver requests it has received. (UP Comments at 13.) Several parties in this proceeding complain that the RIA has not been effective, but their complaint is that the RIA does not do what it was never intended to do – *i.e.*, provide shortlines with the ability to create competitive options where none had existed before a spin-off, without compensating the affected larger carriers for any resulting loss of revenue. (*E.g.*, WCTL Comments at 2; Alliance for Rail Competition Comments at 10-11.)

Finally, the RIA also provides shortlines the opportunity to negotiate to reduce their interchange commitments in exchange for additional compensation. WCTL and some of its

supporters complain that shippers are not participants in the RIA process (*E.g.* WCTL Comments at 24; Department of Agriculture Comments at 8), but nothing precludes shippers from approaching shortlines and offering to place their own money on the table to pay for the competitive access they seek.

* * *

The Board should deny WCTL's renewed petition and discontinue this proceeding. WCTL and its supporters have not demonstrated that interchange commitments reduce competition or violate the Interstate Commerce Act. Moreover, they are asking the Board to act outside of its lawful authority by adopting and applying a new rule that would unwind transactions undertaken in reliance on long-settled policy.

Respectfully submitted,

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March 28, 2006

**REPLY STATEMENT
OF
WARREN C. WILSON
SENIOR DIRECTOR-RAIL LINE PLANNING
UNION PACIFIC RAILROAD COMPANY**

My name is Warren C. Wilson. I am Senior Director Rail Line Planning for Union Pacific Railroad Company ("UP") and am responsible for UP's relationships with shortline and regional railroads. I previously submitted a statement filed March 8, 2006 in this proceeding.

My earlier statement addressed at length the reasons why shortline transactions containing "interchange commitments" benefit both railroads and their customers. In this statement, I want to reinforce those points by responding to the major contentions made by the parties supporting a "paper barrier" rulemaking, and then specifically address the comments filed by Ameren Energy Fuels and Services Company ("Ameren") as to a UP 1999 line sale transaction with Missouri Central Railroad ("MCRR").

I. General Comments

The parties seeking removal of interchange commitments in shortline spinoff transactions claim that interchange commitments are "anticompetitive" and that shortlines and their customers would be better off if interchange commitments were prohibited. As discussed below, UP structures its interchange commitments to preserve shippers' competitive options and to facilitate transactions that benefit shortlines and their customers.

A. Impact on Competition.

I discussed this issue at length in my previous statement, but there are two central points which are worth repeating:

First - Interchange commitments are a legitimate feature of shortline spinoffs. They are typically one part of a bundle of arrangements designed to create an ongoing,

cooperative venture between the Class I road and the shortline. Further, interchange commitments allow the transaction to be priced so that the shortline can afford it. Without interchange commitments, UP would build the going concern value ("GCV") of the traffic generated by the line into the lease rate or sale price. This would, in turn, require the shortline to use much of its cash flow to pay rental, or principal and debt service on sale prices. As noted in my earlier statement, most of UP's shortline spinoffs are leases, and the rental payments are typically "zero" if the shortline fully meets the interchange commitments. That allows the shortline to use its available cash to maintain its physical plant and provide service.

Second - While there is a lot of rhetoric in some of the comments about "competition," the simple fact is that UP's shortline spinoffs do not, in any way, result in a lessening of competition. That is not an accident. We deliberately structure our shortline deals to preserve all competitive options shippers had prior to the transaction. In fact, these transactions are usually procompetitive, because they make the UP-shortline service more attractive than it might otherwise have been. Of course, those supporting a "paper barrier" rulemaking might say that the service would be even more competitive if the interchange commitments did not exist. But, absent the interchange commitments, most of these transactions would never have occurred at all.

B. Impacts on Customers and Shortlines

1. Impact on Shortline Customers

Most of those advocating the voiding of interchange commitments claim that shortline customers would be better off if these commitments did not exist, primarily because these commitments supposedly increase rates by limiting alternative routes. That is simply not the case.

First - Those making this claim forget one important point. If leasing or selling railroads could not use interchange commitments in shortline spinoff deals (or could only

have them for, say, 5 years, as WCTL and others are advocating), the GCV of the interchange traffic generated by the line would be built into the lease rental or the selling price.¹ Some of the comments recognize this, but they fail to understand its ramifications. If the shortline has to use a big part of its cash flow to pay rent, or to pay off acquisition debt, that money has to come from somewhere, and that "somewhere" is the rail customers using the line. This means that the shortline has to establish higher rates for its service than it otherwise could have set. That higher rate may show up as a higher handling charge to its connecting Class I roads (which will, in turn, result in a higher Class I rate to its customers) or it may show up as a direct charge to the shortline customers. But either way, it will ultimately be paid by the shipper and/or receiver of the shortline traffic. There is no free lunch.

Second - My comment about a "free lunch" leads directly to my next point. The parties seeking removal of interchange commitments in consummated spinoff deals are obviously presuming that these commitments would simply be removed without any changes in the compensation or other terms of the deals. In other words, using UP's

¹ Some of the commentators argue that the leasing or selling railroad should be able to capture the value of the traffic only for the portion of the movement which takes place on the leased or sold lines, excluding what the leasing or selling road earns from the traffic on other parts of its system. (WCTL December 21, 1998 Petition, Appendix B, p. 2; Department of Agriculture Comments, p. 7.) In effect these parties are saying there is an "on-branch GCV" and an "off-branch GCV". That is economically irrational. GCV is the capitalized value to the leasing or selling road of the earnings from the traffic generated by the spinoff line, and it can't legitimately be pro-rated into "on-branch" and "off-branch" buckets. That's because, if the leasing or selling railroad loses the traffic, it loses the entire GCV, not some arbitrary pro-ration of it. This is similar to the treatment of freight revenue in abandonment proceedings. When determining the financial impact of an abandonment under Board rules, the abandoning carrier treats all of the revenue from traffic generated by the line as lost. It does not pro-rate the revenue into "on-branch" and "off-branch" buckets and assume that only the "on-branch" bucket will be lost. The reason is, simply, because if the line is abandoned, all of the traffic generated by the line, and all of the revenue it produces, will be lost, not just an arbitrarily determined "on-branch" portion.

lease with Missouri and Northern Arkansas Railroad ("MNA") as an example, UP currently receives zero rent from MNA for the use of this property.² UP actually pays MNA for the traffic MNA interchanges with UP. The "compensation" UP receives for this property is the value of the traffic it interchanges with MNA. What these parties apparently expect is that, if the interchange commitment would be removed, UP would still get "zero" rent for the property, and would potentially lose the value of all the interchange traffic.³

I'll leave it to the lawyers to address whether the Board can confiscate UP's property without compensation in this fashion. I would simply point out that none of the parties advocating this solution would tolerate it for a moment in their own businesses. Imagine that a regulator ordered Entergy to turn over, say, 20% of its generating capacity to another utility company, without any compensation to Entergy for the facilities,⁴ and the other utility then used this generating capacity to take business from Entergy. Many of the same arguments being made in this proceeding could also be made in support of such an action. Obviously, allowing the other utility to use Entergy's facilities for free would artificially "enhance competition" in the markets for electric power currently served by Entergy. No doubt, by introducing a competitor that did not have to pay for its generating facilities, it would also result in lower electricity rates, and lower electricity rates would almost certainly have beneficial, downstream effects. Somehow, I do not think that Entergy would take very kindly to this. Further, if such a measure were broadly applied to the utility industry, investors would stop investing in electric utilities, as

² MNA also has trackage rights over connecting UP lines for purposes of interchange, for which they paid \$1.

³ Actually, under the lease as written, MNA would be required to pay the full lease amount if the interchange provision (which reduces the rental) were "voided." See MNA Lease §4.01 (attached as Exhibit 1 to the comments of Entergy Services, Inc. ("Entergy")). Presumably, the rule proponents would seek to "void" this as well.

⁴ I've use 20% because approximately 20% of UP's traffic originates and terminates on shortlines.

would occur in the rail industry if third parties could lay claim to revenue-generating assets without paying for them.

But let's not stop with electric utilities. The "benefits" of this policy can be applied to other industries as well - for example, the agriculture interests represented by the Wheat & Barley Commissions. Perhaps a regulator should require that wheat farmers turn over, say, 20% of their active acreage to tenant farmers, at zero rent. The tenants could sell the wheat produced on this acreage into the same markets as the owners. Again, this would "enhance" competition, almost certainly result in lower prices, and the lower food prices could have favorable effects through the economy. Of course, wheat farmers would not tolerate such a confiscation of their property for a moment, and rightly so. But fundamentally, it is no different from what the parties favoring the removal of interchange commitments are advocating in this proceeding.

2. Impact on Shortlines

A few of the parties argue that interchange commitments should be removed because Class I railroads use them to destroy the traffic base of shortline railroads. (See Comments of the Wheat & Barley Commissions.) I know of one isolated case involving such an accusation with respect to one particular shortline which did not involve UP. (I don't know all of the particulars, but the case was settled when the Class I road agreed to buy back the shortline.) However, from UP's standpoint, this is a ridiculous accusation. It presumes that a Class I railroad like UP enters into a shortline spinoff deal for the purpose of driving the shortline out of business. That behavior would be irrational. If there is not enough traffic to sustain a shortline, we would abandon the line rather than lease or sell it. If there is enough interline business to sustain the line, then driving the shortline out of business would also deprive UP of its share of the interline revenue.

The reality is that our shortline spinoffs (like MNA) are valuable business partners. Far from driving them out of business, we want them to be successful. We have frequently provided our shortline connections with various forms of assistance, including track material, either free or at below-market prices, which we are not obligated to do under our agreements. Recently, we voluntarily increased the per-car charges we were paying a shortline to help it restore a leased line which had been taken out of service by a tunnel collapse. This is not to suggest we never have differences of opinion with particular shortlines on some issues, but we are in no way trying to deprive them of business opportunities or drive them out of business. Their opportunities are our opportunities.

3. Abandonment Issues

Some of the comments reflect a misunderstanding of how shortline spinoff transactions relate to abandonments.

First - Some parties complain that shortline spinoff transactions are no longer limited to lines which are potential abandonment candidates. (WCTL Comments, p. 21.) In fact, UP shortline spinoffs were never limited to lines which were potential abandonment candidates. Many of them (like MNA) involved line segments which had a very substantial GCV and were never in danger of abandonment.⁵ Rather, these shortline spinoffs were driven primarily by the shortline's lower costs (at least when the transactions were done) and the better service a shortline could provide. It is not clear to me why WCTL considers the fact that not all shortlines were abandonment candidates to help its position. The fact that a shortline spinoff involves a viable rail line with a GCV above net liquidation value ("NLV") is a strong reason to not remove the interchange commitments that apply to the deal. That is particularly true of a transaction

⁵ MNA currently interchanges approximately 100,000 cars per year with UP.

like the MNA lease, where the shortline uses rail line segments which produce very valuable business, but pays UP zero rent. All of UP's compensation comes from the traffic MNA interchanges with UP.

Second - WCTL and Ameren question whether interchange commitments really do help preserve rail lines that would otherwise be abandoned. Ameren goes on to suggest that there is a tension between the abandonment avoidance rationale and the claim by Class I roads that removing "paper barriers" would rob the railroad of its "full franchise value." (WCTL Comments, pp. 21-22; Ameren Comments, p. 9.)

The answer to these comments is provided by the very transactions they focus on - the MNA lease and the MCRR line sale. The MNA lease and an associated sale involved a rail line running from Pleasant Hill, Missouri (near Kansas City) to Newport (Diaz Junction), Arkansas. As discussed above, the coal traffic being handled to the two utilities on MNA was valuable, and the MNA line segments necessary to serve them were not abandonment candidates. It is this traffic which represents the bulk of UP's GCV (or, as Ameren calls it, "full franchise value") in the MNA system. But UP would not have needed the entire MNA rail system to handle this traffic. Based on the way UP looked at secondary main lines in the early 1990's, what probably would have happened, is that UP would have retained the line segments on the east and west ends of MNA, served the utility plants from the two ends of the line and abandoned the middle portion (approximately 102 miles between Bergman and Guion, Arkansas) but for the alternative of spinning off all three segments through a combination of sales and leases. This is an example of a spinoff transaction that prevented a line abandonment, and yet involved a healthy GCV.

The MCRR line sale highlighted by Ameren is another example. Ameren itself admits that this line was "heading for abandonment." (Ameren Comments, p. 7.) The line sale to MCRR saved the line (at least for the time being). But the key to the line sale

was that the purchase price was based on the line's NLV (and, even at that, the buyer could not come up with the funds until Ameren bankrolled it). An NLV-based price was only possible because Labadie access was not included. Had this access been included, the purchase price would have been much higher to compensate for the value of the revenue opportunity. Had the purchase price been higher than NLV, there would almost certainly have been no sale, and the line would have been abandoned. I note that, while Ameren complains that it had no role in the "deal terms" GRC had agreed to, it conspicuously fails to say that it was willing to pay a higher price to include Labadie access rights. In the next section, I will discuss how Ameren was able to secure access for a second railroad, BNSF, to its Labadie plant without having to pay for MCRR access.

II. Ameren and the Missouri Central

Ameren operates a generating plant at Labadie, Missouri. The plant is physically served by two rail lines. One is a former Missouri Pacific ("MP") line between Kansas City and St. Louis, which is UP's main line across Missouri. The other is a former Chicago, Rock Island and Pacific line between St. Louis and Kansas City, which was acquired by Southern Pacific ("SP") in 1980. In 1999, after the UP/SP merger, UP sold the former SP line to MCRR. Before the merger, SP had used only the portion of the line between St. Louis, Labadie and Owensville, Missouri, as it had trackage rights over the MP line for its overhead traffic. MCRR has similarly operated only the St. Louis - Owensville segment of the line.

Ameren tries to create the impression that the MCRR line sale - which included a contractual restriction on MCRR service to the Labadie Plant - somehow removed a competitive option which Ameren previously had. It did not. The line sale was made in 1999. At that time, the Labadie Plant was physically served only by UP, which owned both of the rail lines serving Labadie since 1996. UP was serving Labadie only from the

former MP line, not the SP line. As such, the sale of the SP line to MCRR in 1999 did not eliminate any of Ameren's existing competitive or service options.

What may make the Ameren situation seem complex is that, at the time of the 1999 sale, Ameren was party to a "proportional rate" agreement, which it had made with UP in 1996 to address the "2-to-1" status of the Labadie Plant in the UP/SP merger. This arrangement was designed as a means for BNSF to compete for Labadie Plant traffic using a UP proportional rate applicable to the former MP main line between Kansas City and Labadie. The proportional rate agreement did not involve use of the SP (MCRR) line, and it was not affected in any way by the MCRR line sale. Subsequently, Ameren was able to obtain direct BNSF access to Labadie over the MP line (Pacific to Labadie) as a result of UP/SP Decision No. 89.⁶ Like the proportional rate, the BNSF rights also did not involve use of the SP (MCRR) line and were not affected in any way by the line sale.

Ameren's complaint about the restrictions in the MCRR line sale is particularly ironic given UP's prior efforts to use this line to address the "2-to-1" status of the Labadie Plant in the UP/SP merger. UP recognized, even before filing its merger application, this issue had to be addressed. As a result, UP proposed in its settlement negotiations with BNSF that BNSF purchase the SP line to serve Labadie. Had BNSF accepted this proposal, it would simply have replaced SP on the line: a one-for-one replacement for the lost SP competition. But BNSF declined to purchase the line in September, 1995. UP then proposed to Ameren that it could purchase the SP line or that UP could give trackage rights over the line to another railroad to serve Labadie. Ameren declined to pursue any options involving the SP line, and, instead, negotiated the proportional rate agreement with UP.

⁶ 4 S.T.B. 879 (2000).

When the proportional rate agreement was made (1996), UP believed that it had resolved Ameren's competitive concerns at Labadie, and that the SP line was no longer needed for this purpose.⁷ As such, we began serious negotiations with General Railway Company a/k/a MCRRI ("GRC") for sale of the SP line through Labadie and across Missouri, which closed in October, 1999.

Of course, as we now know, Ameren did not remain satisfied with the proportional rate agreement, and, in June, 2000, obtained the right for direct BNSF access to Labadie Plant in UP/SP Decision No. 89. But this access applied over the MP mainline route, not via MCRR. In fact, Ameren and BNSF had no desire to use MCRR to provide access even temporarily. That was demonstrated by their response to a UP June 30, 2000 proposal that BNSF access Labadie via MCRR pending construction of a connecting track at Pacific, Missouri, needed for permanent trackage rights access. BNSF quickly turned this down stating, in part, that "Bob Neff, President of the Missouri Central and Director of Transportation for Ameren, informed UP's Marketing Department of the condition of the Missouri Central track and that use of the Missouri Central, in its present condition, would not be a viable alternative for movement of coal to the Labadie Plant."⁸ The letter went on to criticize UP for even making such an offer. As a result, UP and BNSF entered into an interim trackage agreement applicable over the MP line.

I mention this history to demonstrate that neither Ameren nor BNSF ever had any serious interest in using the MCRR line for access to the Labadie Plant and, in fact, declined UP proposals that involved use of this line. Their lack of interest in using the MCRR line is not surprising, since the former MP line was a far superior route.

⁷ In fact, Union Electric (now Ameren) made a filing with the Board on March 25, 1996 in which it stated that "UE and UP have reached an agreement that will insure on-going competition for rail service to the Labadie plant after the merger." (Verified Statement of Udo A. Heinze, Union Electric, included in UP/SP-195, filed March 29, 1996.)

⁸ BNSF letter to UP dated July 7, 2000, copy attached.

Ameren goes on to complain that "BNSF has not moved any significant amount of coal to Labadie because BNSF's rates have not provided a competitive alternative." (Ameren Comments, p. 6.) In other words, Ameren continues to use UP because UP's rates are lower than BNSF's. This had absolutely nothing to do with the MCRR line sale. If BNSF is unwilling, for whatever reason, to establish lower rates than UP for its direct, trackage rights access to Labadie, it is certainly not going to do so via the inferior MCRR routing.

Finally, Ameren complains that the MCRR Labadie restrictions "had no apparent relation to the sale price or any other legitimate purpose, particularly in light of the condition of the line being sold." (Ameren Comments, p. 8.) That is simply not true - the restrictions had a direct impact on the sale price. While the actual sale price is confidential, I can say that the price MCRR paid reflected the NLV of the line. As I previously discussed, if access to Labadie had been included, the purchase price would have been much higher. GRC was well aware of this during the sale negotiations, and did not want Labadie access if it would result in a higher price. Considering that GRC was unable to even come up with an NLV-based purchase price before Ameren stepped in, it is fair to say that the line sale would never have occurred had Ameren access been included, and the entire line would have been abandoned.

VERIFICATION

Warren C. Wilson, Senior Director-Rail Line Planning of Union Pacific Railroad Company, under penalty of perjury, declares and verifies that he has read the statement in Ex Parte No. 575, knows the facts stated therein, and that said facts are true as stated.

Dated: March 24, 2006.


Warren C. Wilson

**REPLY VERIFIED STATEMENT
OF
F. M. "RICK" GOUGH**

My name is Rick Gough. I am Senior Business Director - Energy for Union Pacific Railroad Company ("UP"). I have been employed by UP for more than 20 years, and I have served as Senior Business Director - Energy since June 1, 2000. In my current role, I have primary responsibility for commercial aspects of relations with many of UP's customers that ship large quantities of coal from the Powder River Basin ("PRB") in Wyoming, including Entergy Services, Inc., and Entergy Arkansas, Inc. (collectively referred to as "Entergy"). My direct dealings with Entergy date back to 1983, when UP, Western Railroad Properties, Inc. ("WRPI"), and Missouri Pacific Railroad Company ("MP") first entered into long-term contracts to deliver PRB coal to Entergy, which was then named Arkansas Power & Light Company. As a result of my work, I am generally familiar with the 1992 lease agreement between UP and Missouri and Northern Arkansas Railroad Company ("MNA"), including the terms that affect MNA's right to handle unit train coal traffic to Entergy's plant at Independence, Arkansas.

This statement responds to comments filed by Entergy and Arkansas Electric Cooperative Corporation ("AECC") by providing a more complete and accurate description of the effects of the MNA lease, and particularly the interchange commitment contained in that lease, on the transportation of coal to Entergy's plant at Independence.

For the purposes of this proceeding, the most important point to remember about the MNA lease is that it did not eliminate any competitive option that benefited Entergy's plant at Independence. Thus Entergy and AECC are wrong to suggest that rail rates to Independence would be lower but for the MNA lease.

Entergy's Independence plant is located on a former MP line that runs between western Missouri and northeastern Arkansas. AECC misleadingly implies that the MNA lease

eliminated the competitive option of having a neutral MP quote a rate between an interchange with BNSF Railway and Independence. It claims that “the former MP would have aggressively pursued movements associated with alternative sources” but that “paper barriers inhibit MNA’s willingness.” (AECC Comments at 7.) However, MP was not a neutral carrier when MNA leased the line to Independence. UP acquired control of MP in December 1982, long before the 1992 MNA lease, and even before commercial operations began at the Independence plant in 1983. The MNA lease thus did not extinguish a competitive option available to Entergy.

Entergy and AECC are also wrong when they claim that the MNA lease has prevented BNSF from providing relief when UP has experienced service problems. (Entergy Comments at 4 & Herndon VS at 7-8; AECC Comments at 6.) Entergy points specifically to UP’s 1997-1998 service problems and states that UP “categorically” refused to waive MNA’s interchange commitment and allow BNSF to deliver trains to MNA for forwarding to Independence. (Herndon VS at 8.) Entergy is incorrect. The fact that BNSF did not handle Entergy trains had nothing to do with the MNA lease. UP told Entergy in 1997 that it was prepared to have BNSF handle Entergy trains via interchange with MNA on a temporary, detour basis, but it was not willing to relinquish its rights under its long-term transportation contract with Entergy. These detours never occurred, apparently because BNSF was not willing to handle the business on a temporary basis.

AECC does not specifically mention UP’s 1997-1998 service problems, but it complains that in 2005 the MNA interchange commitment “made it impossible for Independence to receive BNSF-originated PRB coal during the lengthy time when only UP was operating under Force Majeure.” (AECC Comments at 6.) However, as Entergy recognizes, BNSF’s PRB coal was not a viable option at that time because “BNSF was also having difficulty meeting its commitments.” (Herndon VS at 8.) I am unaware of any recent occasion on which Entergy

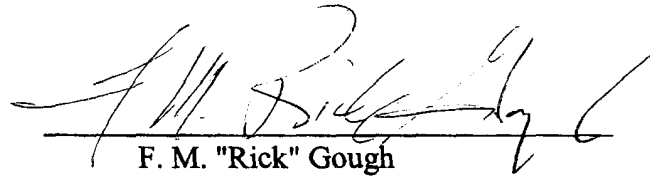
asked UP to waive the MNA interchange commitment and allow MNA to work with BNSF to handle PRB coal that UP was unable to deliver.

Finally, Entergy and AECC are wrong when they suggest that the MNA lease has undermined Entergy's efforts to move non-PRB coal to Independence. (Entergy Comments at 4 & Herndon VS at 8; AECC Comments at 6-7.) UP has been very responsive to Entergy's efforts to obtain substitute coal over the past year, when neither UP nor BNSF could transport as much PRB coal as shippers were demanding. As AECC notes (AECC Comments at 7), UP cooperated with Entergy's efforts to move substitute Colorado coal to Independence. UP also cooperated with Entergy's efforts to move import coal from the Gulf Coast to Independence by offering to establish a rate and an interchange point for coal that would have moved from a Gulf Coast facility located on Canadian National. The Gulf Coast coal movement never occurred, but I believe it was because Entergy chose to use coal from Colorado instead.

AECC, but not Entergy, argues that the MNA interchange commitment prevents Entergy from obtaining substitute coal or lignite from MNA-served mines in Missouri or BNSF-served or Kansas City Southern-served mines in Oklahoma, Kansas, Texas, or Louisiana. (AECC Comments at 6-7.) To the best of my knowledge, Entergy has never approached UP with a request to move such substitute coal using a non-UP interchange with MNA or from a mine served by MNA. Moreover, UP would waive the MNA interchange commitment if Entergy approached us with a feasible plan to source such substitute coal for Independence using a non-UP connection with MNA in a situation in which UP was unable to meet its obligations to deliver PRB coal to Independence and unable to offer a reasonable through route for the substitute coal.

VERIFICATION

I, F. M. "Rick" Gough, declare and certify under penalty of perjury that I have read the foregoing Verified Statement, that I know its contents, and that those contents are true as stated.



F. M. "Rick" Gough