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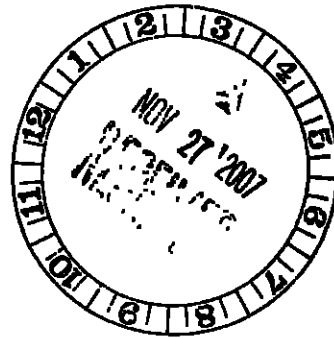
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November 27, 2007

BY HAND

The Honorable Vernon A Williams
Secretary
Surface Transportation Board
Attn STB Ex Parte No 664
395 E Street, SW
Washington, DC 20423-00001



Re Ex Parte No 664 – Methodology to be Employed in Determining the
Railroad Industry's Cost of Capital

Dear Secretary Williams

Enclosed for filing in the above-captioned matter are an original and ten
copies of the Written Testimony of Union Pacific Railroad Company pursuant to the
Board's October 24, 2007 decision

An additional copy of Union Pacific's Written Testimony is also enclosed
Please return a date-stamped copy to our messenger

Thank you for your attention to this matter

Sincerely,

Michael L Rosenthal

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Office of Proceedings

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Public Record

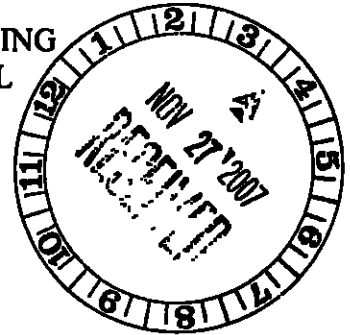
Enclosure

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No 664

**METHODOLOGY TO BE EMPLOYED IN DETERMINING
THE RAILROAD INDUSTRY'S COST OF CAPITAL**

**WRITTEN TESTIMONY
OF UNION PACIFIC RAILROAD COMPANY**



PRESENTED BY

JAMES R. YOUNG

**CHAIRMAN, PRESIDENT, AND
CHIEF EXECUTIVE OFFICER**

**UNION PACIFIC CORPORATION
UNION PACIFIC RAILROAD COMPANY**

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Office of Proceedings**

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**Part of
Public Record**

**Date of Submission November 27, 2007
Date of Public Hearing December 4, 2007**

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No 664

**METHODOLOGY TO BE EMPLOYED IN DETERMINING
THE RAILROAD INDUSTRY'S COST OF CAPITAL**

**WRITTEN TESTIMONY
OF UNION PACIFIC RAILROAD COMPANY**

INTRODUCTION

My name is Jim Young I am chairman, president, and chief executive officer of Union Pacific Corporation and Union Pacific Railroad Company I appreciate the opportunity to testify in this proceeding, which is critically important to my company and to the national transportation system

The outcome of this proceeding will play a crucial role in determining how extensive – or how limited – the nation's rail system will be as we proceed into the 21st Century. Union Pacific has been investing for long-term growth, but the Board's actions threaten to undermine the expectations that have allowed us to pursue a growth strategy It is essential that the Board focus on the implications of its actions over the long-term, because railroads must take a long-term perspective when we make our decisions about capital spending If the Board puts at risk our ability to earn sufficient returns on investment over the long term, our shareholders will recognize that risk, require us to curtail capital investments, and take their money elsewhere The result will be that potentially beneficial infrastructure investments will not be made and service that

customers demand will not be possible on the rail network. That is not a result that we want, it is not a result that our customers want, and it is not a result that the Board should want. Above all, it is not the result America needs.

We urge the Board to approach this proceeding with a long-term view of the public interest. We believe the public interest will be best served in the long term by adopting policies that encourage investment in our nation's rail system. Investment in the our nation's rail system will provide needed transportation capacity, reduce greenhouse gas emissions, move this country further along the path to energy self-sufficiency, and improve our global competitiveness. We would hope that the Board would pursue strategies that will help to accomplish these goals.

A. Union Pacific Has Been Investing For Long-Term Growth.

As the Surface Transportation Board is well aware, our nation is facing a transportation infrastructure crisis. Every mode is being stretched beyond its limits. As the only mode that pays for its own infrastructure, the rail industry is under additional pressure, because it must generate a sufficient return on investment to build new capacity while also maintaining and then replacing existing infrastructure as it approaches the end of its useful life. These investments are very expensive. For example, we are replacing one of the highest major railroad bridges in the United States in Boone, Iowa, at a cost of over \$40 million, and many more bridges must be rebuilt in coming years. We realize that our customers do not enjoy paying for infrastructure, but there is no plausible alternative.

As our earnings have improved, Union Pacific has responded to the challenges of providing adequate rail infrastructure and has been investing for long-term

growth. Our capital budget for this year is \$3.1 billion – the largest amount in our history. We have been making substantial and increasing investments in growth capital during the last few years because we and our shareholders believed that our returns on investments would continue to improve to justify these high levels of investment in assets that will last for decades. But if we are going to continue to prudently invest in the capacity our customers want and our nation needs, we need some assurance that regulatory action will not undermine our efforts to earn a return on investment sufficient to justify those investments.

B. The Board's Proposal Would Undermine Expectations About Long-Term Earnings Prospects And Reduce Infrastructure Investment.

The Board's current proposal to change how the cost of equity capital is calculated produces results that are unrealistically low. As other participants in this proceeding have discussed and will discuss, it produces results that are below similar calculations by economic experts and agencies that regulate other network industries. Even more important, the proposal produces results that are well below real-world investor expectations. Ultimately, it is investors' return requirements for their funds that determines the cost of capital. They can earn more, at less risk, by investing in other industries and other nations than the level of return the Board has calculated for railroads.

If adopted, the Board's proposal would directly reduce our ability to continue investing for long-term growth, as our returns would be subject to increased regulatory constraints. The immediate effect of the Board's proposal would be to increase both the amount of traffic subject to rate regulation and the size of the rate reductions that could be granted in rate proceedings. The longer term effect would be to create the misimpression that we are actually earning our cost of capital, which could

subject us to additional regulatory constraints. The proposal does not address the implications of those additional constraints, so it sows the seeds of uncertainty and creates even greater risk for investors. Thus, the question we would be forced to ask is whether we can justify investing in new capacity today when our returns – which are too low now – will be even further constrained in the future in both predictable and unpredictable ways.

As a publicly owned company, we cannot ignore the need to justify our investments in new capacity. We have a fiduciary duty to our owners – our shareholders – to operate the company in a profitable manner and make prudent decisions regarding future capital investments. The shareholders of Union Pacific will simply not allow management to invest capital in initiatives that have an unreasonably low rate of return imposed upon them. Shareholders would demand the company reduce capital spending, and, ultimately, both debt and equity investors will send their money outside the rail industry as the free market efficiently allocates capital to companies that provide better returns with lower risks.

Moreover, we and our shareholders must consider these issues before we commit substantial funds to new investments. The capital investments we make have very long lives and require us to commit substantial additional capital over the years to maintain their utility. As a result, our decisions about whether to invest in growth today require us to consider carefully not only the risks we face today, but also those we face in the future. As the agency with regulatory oversight of the rail industry, the Board also must take a long-term view and assess the potential impact of its proposal, not just on the

rates that shippers pay today, but also on whether the industry will be able to meet our nation's transportation needs in the future

C. The Board Must Consider The Implications Of Its Actions On The Long-Term Health Of The Rail Industry And Its Customers.

As part of my responsibilities as Union Pacific's chief executive officer, I spend a substantial amount of time talking to our customers. Those discussions have helped drive home for me what is truly at stake in this proceeding.

There is an interesting dichotomy between what policymakers in Washington hear, and what I hear when I meet with our customers. While customers are certainly concerned about controlling their costs, I can tell you that, for the vast majority of our customers, their primary concern is whether we will be investing for their future. We can only be there for them if we can earn a reasonable return on our investments.

To earn a reasonable return on investment, we must be able to realize sufficient revenues, and those revenues must come from our customers. Since the inception of the rail industry, many of the challenges we have faced have changed, but one constant remains – we can only build and maintain the size rail network that shippers – our customers – are willing to pay for. To some, that is a harsh truth, but a truth nonetheless.

The decisions the Board makes in this proceeding will directly affect whether we can earn a sufficient return on investment and thus how extensive the national rail system will be. If the Board's calculations create an artificially low limit on our investment returns, we will be unable to replicate the existing rail infrastructure, much less expand it substantially, as the public interest requires. If the Board believes, as we and the Department of Transportation do, that the demand for rail will grow and the

highway system will be increasingly strained, then we should be doing everything we can to accelerate investment in rail capacity. Our company and the railroad industry have demonstrated that we will invest when the market demands it and the opportunity for adequate returns justify it. The Board should not stifle that opportunity.

Our country's freight railroads are finally approaching a point where the financial returns justify new investment. We should be discussing how to create additional incentives to expand investment in the rail network, not actions that will restrict it. It would be tragic indeed if government policy changes were to reduce the growth potential for a significant component of our country's vital infrastructure. The Board's proposal will do that. The Board certainly should not want to pursue such a detrimental policy.