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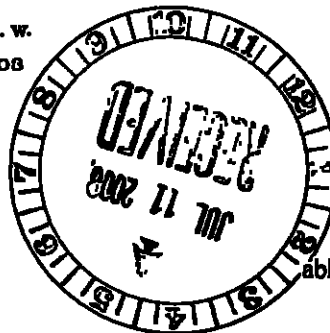
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July 11, 2008

BY HAND DELIVERY

The Honorable Anne K. Quinlan
Acting Secretary
Surface Transportation Board
395 E Street, S.W.
Washington, D.C. 20423-0001

ENTERED
Office of Proceedings

JUL 11 2008

Part of
Public Record

Re: Docket No. 42104, *Entergy Arkansas, Inc. and Entergy Services, Inc v. Union Pacific R.R. and Missouri & Northern Arkansas R.R. Co., Inc.*; F.D. No. 32187, *Missouri & Northern Arkansas R R – Lease, Acquisition and Operation Exemption – Missouri Pacific R.R. and Burlington N. R R*

Dear Ms. Quinlan:

Enclosed for **FILING UNDER SEAL** in the above-referenced proceeding please find a separately packaged original and ten (10) copies of Complainants' Opening Evidence and Argument. This filing includes one volume of witness statements and argument of counsel, and a separate volume of counsel's exhibits. Each volume contains **COLOR COPIES**, as noted. We also are enclosing, for **FILING UNDER SEAL**, disks containing electronic versions of the materials and supporting workpapers.

We also have enclosed an original and ten copies of a **REDACTED, PUBLIC** version of this Opening Evidence and Argument for filing on the Board's public docket. We have enclosed additional copies of each version of the filing to be date-stamped and returned to the bearer of this filing. Thank you for your attention to this matter.

Sincerely,

Andrew B. Kolesar III
An Attorney for Entergy Arkansas, Inc.
and Entergy Services, Inc.

Enclosures

JUL 11 2008

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Public Record

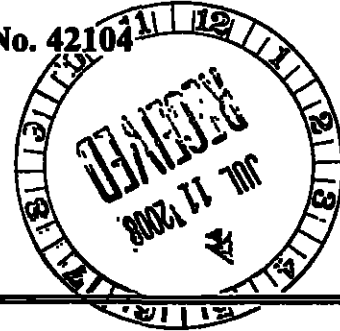
BEFORE THE
SURFACE TRANSPORTATION BOARD

ENTERGY ARKANSAS, INC. and
ENTERGY SERVICES, INC., Complainants

v.

UNION PACIFIC RAILROAD
COMPANY and MISSOURI &
NORTHERN ARKANSAS RAILROAD
COMPANY, INC., Defendants.

Docket No. 42104



MISSOURI & NORTHERN ARKANSAS
R.R. – LEASE, ACQUISITION AND
OPERATION EXEMPTION – MISSOURI
PACIFIC R.R. and BURLINGTON N. R.R.

Finance Docket No. 32187

OPENING EVIDENCE AND ARGUMENT

REDACTED, PUBLIC VERSION
– MATERIAL UNDER SEAL DELETED –

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Dated: July 11, 2008

Attorneys & Practitioners

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

ENTERGY ARKANSAS, INC. and ENTERGY SERVICES, INC., Complainants	)	
	)	
v.	)	Docket No. 42104
	)	
UNION PACIFIC RAILROAD COMPANY and MISSOURI & NORTHERN ARKANSAS RAILROAD COMPANY, INC., Defendants.	)	
	)	

MISSOURI & NORTHERN ARKANSAS R.R. – LEASE, ACQUISITION AND OPERATION EXEMPTION – MISSOURI PACIFIC R.R. and BURLINGTON N. R.R.	)	
	)	
	)	Finance Docket No. 32187
	)	

OPENING EVIDENCE AND ARGUMENT

Entergy Arkansas, Inc. (“EAI”) and Entergy Services, Inc. (“ESI”) (collectively, “Entergy”) hereby submit this Opening Evidence and Argument in accordance with the revised procedural schedule in effect in this case. *See Entergy Arkansas, Inc and Entergy Services, Inc. v. Union Pacific R R and Missouri & Northern Arkansas R.R., STB Docket No. 42104, et al.* (STB served May, 19, 2008) at 6.

Entergy’s Opening Evidence and Argument consists of the following individual portions:

- (1) the Verified Statement of Mr. William M. Mohl, Vice President – System Planning & Operations for Entergy Services, Inc.;
- (2) the Verified Statement of Mr. Daniel B. Gray, Senior Transportation Analyst for Entergy Services, Inc.;
- (3) the Verified Statement of Mr. Thomas D. Crowley, President of L.E. Peabody & Associates, Inc.;
- (4) the Joint Verified Statement of Dr. John E. Kwoka, jr. and Dr. Frederick R. Warren-Boulton of Microeconomic Consulting & Research Associates, Inc. (“MiCRA”); and
- (5) Entergy’s Argument of Counsel.

Through its February 19, 2008 “Verified Complaint and in the Alternative Petition to Revoke in Part” (“Complaint”), Entergy seeks a determination from the Board that the continued enforcement of certain provisions of the 1992 lease agreement between Defendant Union Pacific Railroad Company (“UP”) and Defendant, the Missouri & Northern Arkansas Railroad Company, Inc. (“M&NA”) (“UP/M&NA Lease”) (*see* Counsel’s Exh. No. 1) constitutes an unreasonable practice.

The provisions of the lease that are at issue in this proceeding operate as a “paper barrier” preventing M&NA from interchanging Entergy’s coal traffic with a rail carrier other than UP. The continued enforcement of these provisions constitutes an unreasonable practice in violation of Title 49 and is otherwise against the public interest and in violation of public policy.

In the alternative, Entergy petitions under 49 U.S.C. § 10502(d) that the Board revoke, in part, the exemption noticed in *Missouri & Northern Arkansas R.R. – Lease, Acquisition and Operation Exemption – Missouri Pacific R.R. and Burlington Northern R.R.*, ICC Finance Docket No. 32187 (ICC served Dec. 22, 1992). Specifically, Entergy requests that the Board revoke the exemption to the extent that it permits UP to enforce the paper barrier provisions of the lease restricting the interchange of Entergy's traffic. Revocation of the exemption to this extent is necessary because application of Title 49 is necessary to carry out the transportation policy set forth in 49 U.S.C. § 10101.

Further in the alternative, Entergy requests that the Board find that the subject lease constitutes a pooling and/or traffic division arrangement as to which agency authorization under Title 49 was not properly obtained. *See* 49 U.S.C. § 11322; *see former* 49 U.S.C. § 11342.

Since this is a case of first impression before the Board, broad discretion exists with regard to the specific relief that the Board may impose upon a finding that the continuation of the status quo under the lease is an unreasonable practice or contrary to the public interest. Entergy therefore has endeavored to develop a number of different potential forms of relief that would be appropriate. Those specific requests for relief are set forth at the conclusion of Entergy's Argument of Counsel.

Mohl V.S.

**VERIFIED STATEMENT
OF
WILLIAM M. MOHL**

My name is William M. Mohl. I am currently the Vice President System Planning & Operations for Entergy Services, Inc. ("ESI"). My business address is 10055 Grogan's Mill Road, Parkwood II Building, Suite 300, The Woodlands, TX 77380.

I am submitting this Verified Statement in support of ESI and Entergy Arkansas, Inc.'s ("EAI") Complaint and related Petition for Revocation of Exemption, through which ESI and EAI seek to prevent the continued enforcement of certain provisions of the 1992 lease agreement between Defendant Union Pacific Railroad Company ("UP") and Defendant, the Missouri & Northern Arkansas Railroad Company, Inc. ("M&NA") that operate as a "paper barrier" preventing M&NA from interchanging EAI's coal traffic with a rail carrier other than UP. *See* Counsel's Exhibit No. 1. This barrier to potential interchange has posed, and continues to pose, a significant threat to ESI and EAI's ability to obtain reliable coal transportation service to the Independence Electric Steam Generating Station ("Independence"), which is located near Newark, Arkansas.

As Vice President System Planning & Operations, I have executive responsibility for all planning, operations, fuel supply, and related commercial activities for the Entergy System and the Entergy Operating Companies including the procurement of coal for Entergy's fuel and generation resources to meet the needs

of the various Entergy Operating Companies. The Entergy Operating Companies include Entergy Arkansas Inc. ("EAI"), Entergy Gulf States Louisiana, LLC ("EGSL"), Entergy Louisiana, LLC ("ELL"), Entergy Mississippi, Inc. ("EMI"), Entergy Texas, Inc. ("ETI"), and Entergy New Orleans, Inc. ("ENOI"). The Entergy Operating Companies provide electricity to more than 2.7 million customers in Arkansas, Louisiana, Mississippi and Texas.

As part of my responsibilities I have executive responsibility for the Coal Supply Management Group, which is responsible for planning coal purchases for and coal deliveries to the coal-fired generating stations owned by the Entergy Operating Companies. In total, the Entergy Operating Companies own and operate three coal stations and have an interest in a fourth coal station. EAI has an ownership interest in and operates the White Bluff Steam Electric Station ("White Bluff") located in Redfield, Arkansas and the Independence Steam Electric Station ("Independence") located in Newark, Arkansas. EGSL owns and operates the Roy S. Nelson Steam Electric Station located in Mossville, Louisiana and owns a 42% interest in Big Cajun II, Unit 3 located in New Roads, Louisiana.

The focus of my testimony in this proceeding relates to coal deliveries to *Independence*, which consists of two units. EAI acts as the operator of these units and is responsible for the management of fuels and operations for all of the co-owners of the plant.¹ Unit 1 has a maximum dependable capability of

¹ Co-owners of Unit 1 are AECC 35 percent; Entergy Arkansas Inc 31.5 percent, City of Conway 2 percent; City of Jonesboro 5 percent, Entergy Mississippi 25 percent, City of Osceola 0.5 percent, and City of West Memphis 1 percent. Co-owners of Unit 2 are: AECC 35%, City of Conway 2 percent; Entergy

approximately 836 MW and Unit 2 has a maximum dependable capability of approximately 842 MW. Independence was designed to burn low-sulfur southern Powder River Basin ("PRB") coals. Historically, the two units have consumed approximately 6.5 million tons of coal annually. Until recently, virtually all of this coal has been Powder River Basin ("PRB") coal.

Since the commencement of operations at Independence in 1983, all of the PRB coal burned at the plant has been delivered via railroad. Nearly all of the PRB coal that ESI and EAI have purchased for use at Independence originates at mines located on the PRB Joint Line. A loaded EAI train moving on the UP travels southeast along the Joint Line to Shawnee Junction, Wyoming. At Shawnee Junction, the train enters rail lines owned by UP alone. It then continues on Union Pacific's lines to North Little Rock. Trains bound for Independence then head north from North Little Rock to Diaz Junction, where they are handed off by the UP to the Missouri & Northern Arkansas Railroad (M&NA). *See* Counsel's Exh. No. 2. The M&NA then takes the Independence train from Diaz Junction to the plant for delivery. In the last few years, ESI and EAI have routed empty Independence trains northwest on the M&NA to Kansas City, where they return to UP's rail lines for their journey back to the PRB. *See* Counsel's Exh. No. 5.

Power Inc. 14.37 percent, East Texas Electric Cooperative 7.13 percent, City of Jonesboro 15 percent, Entergy Mississippi 25 percent; City of Osceola 0.5 percent; and City of West Memphis 1 percent

Importance of Reliability of Fuel Supply

More than 2.7 million customers depend on the Entergy Companies to provide the lowest-cost electric service possible and to assure that such service is available on a reliable and consistent basis. One of the ways that electric utilities assure that a reliable and economic fuel supply is available is to enter into fuel supply contracts with reliable suppliers.

PRB coal has been, and remains, one of the most cost-efficient fuels for electric utilities. Independence was designed to burn PRB coal and, with rare exception, PRB coal has been the only coal burned at that plant since 1983. The Entergy Companies and their customers rely on the availability of a dependable supply of both PRB coal and PRB coal transportation service for Independence, which is among the lowest-cost units available on the Entergy System and is among the first units dispatched under our economic dispatch protocols. When coal is not available for this unit, EAI and the other Entergy Operating Companies need to replace the generation that is lost from the unit with alternatives that, by definition and under current market conditions, will be higher cost. Typically, replacement of lost coal generation is with higher-cost gas, or purchased power from alternative energy suppliers. While the prices of these alternatives can vary, with rare exception coal has been the lowest-cost option.

ESI and EAI have been responsible for obtaining the shipments of coal to Independence pursuant to long-term coal transportation agreements beginning in 1983. One of the primary functions that these contracts are supposed to serve is to

assure that a reliable supply of coal transportation service is available to deliver coal to Independence.

An Independent M&NA Would Serve the Public Interest

As detailed by Mr. Daniel Gray, there have been three major UP service disruptions since the M&NA lease agreement became effective in 1992. These service disruptions resulted in the Entergy Operating Companies losing nearly { [REDACTED] } tons of coal delivery deficits that were never made up – or almost { [REDACTED] } worth of burn at Independence. The availability and reliability of these coal fired generating units has been undermined in each of these instances. During each of these crises, ESI and EAI experienced extended curtailments at Independence, during which coal burn was restricted and the lost coal-fired generation had to be replaced with higher cost alternatives (*i e* , either natural gas generation or purchased power from other sources of generation). In all three instances, M&NA could have provided much-needed assistance in the form of supplemental coal deliveries but for its lease with UP.

ESI and EAI believe that competition is the answer to these reliability issues. An independent M&NA will assure that ESI and EAI will have options available to at least mitigate the damage that is caused when UP is unable, or unwilling, to deliver all of the coal needs for Independence. The current lease agreement creates a fictional option where it appears that M&NA is independent and available to provide supplemental coal, but in reality the lease agreement is so

onerous that economic interchange of traffic with a non-UP carrier is cost prohibitive.

As we have seen in the past service crises, UP has hidden behind this penalty as a means of precluding any alternative carriers from interchanging with M&NA – even on a temporary, emergency basis. UP steadfastly stood on the terms of its lease and effectively forced ESI and EAI to incur substantial damages relating to replacement energy costs that far exceeded what it would have cost to supplement coal deliveries via M&NA interchange with another carrier, even if M&NA had been obligated to pay a reasonable rental for interchanging with a non-UP carrier (rather than the excessive rental level in the lease).

ESI and EAI are deeply concerned that the threat of service disruptions is not likely to fade away any time soon. The western railroads have been very public about their concerns with regard to the timing of capacity improvements and the need to raise revenues in advance of capacity. They have also made clear that deferral of these investments, in favor of “managing demand through pricing,” was the preferred approach. *See* Letter from UP Executive Vice President – Marketing and Sales, Jack Koraleski to UP Customers dated April 15, 2004 (Exhibit WMM-1). Consistent with this preference, the western railroads have made a dramatic departure in their contracting practices since 2004. It is no secret in the industry that prices for rail transportation service are rising, and that the type of service “commitment” that was once offered to shippers has now become illusory.

The western railroads have shown a reluctance to make capital investments in advance of growth in traffic. As a result, history has shown that surges in demands, or other intervening events (whether controllable or not), can and do cause strains on railroad capacity until the railroads' investments in capacity catch-up with the demand. It has thus become increasingly important, from an electric reliability standpoint, to have transportation options at our generation facilities. Stations like Independence, which are captive to a single railroad – the UP – are most at risk. The fact that Independence is also among the lowest-cost generation alternatives in the Entergy System increases its importance and the need to assure that the fuel supply is not interrupted and that EAI's customers receive reliable power at the lowest cost.

Equally disturbing is UP's new-found zeal for hiding its service failures behind claims of force majeure. In the first twenty-two years (1983 - April 2005) that UP delivered coal to Independence UP declared force majeure a total of 8 times. Only one of these claims (relating to the 1993 Midwestern floods) exceeded a few days. By contrast, in the last three years of service (April 2005-April 2008) UP has declared force majeure 27 times, including the 2005 force majeure that lasted almost seven months. In total, UP's claimed force majeure events have consumed 487.1 days in the last three years. Stated another way, during the last three years UP has claimed to be excused from its delivery obligations to our Arkansas coal plants *for approximately 45% of this time period.* This propensity to claim force majeure further underscores why many shippers,

including ESI and EAI, are becoming increasingly concerned about the reliability of the rail network and how it can impact on the reliability of our ability to provide service.

Indeed, the service problems Entergy has experienced have been so severe and the prospect of further such problems is believed by Entergy to be so substantial that they have forced Entergy to evaluate other means of obtaining alternate rail service at Independence. Towards that end, on February 22, 2008 Entergy submitted a Pre-filing Notice stating its intent to file a Petition for Exemption from the prior approval requirements of 49 U.S.C. § 10901 and 49 C.F.R. Part 1150 for the construction of a new line of railroad that would connect Independence to BNSF near Hoxie, Arkansas. *In the Matter of Entergy Arkansas, Inc and Entergy Services, Inc. – Petition for Exemption – Construction and Operation of a Line of Railroad in Independence, Jackson, and Lawrence Counties, Arkansas*, STB Finance Docket No. 35122. Of course, the construction of this duplicative line to allow Entergy to access alternative service from BNSF might not be necessary if the Board grants Entergy the requested relief from the paper barriers in the UP/M&NA lease agreement. Such relief would benefit the public that Entergy serves in several key respects: (1) it would provide a means to bolster the reliability of coal generation at Independence by assuring that there is a means to obtain supplemental coal deliveries when UP is unable, or unwilling, to deliver coal to Independence; (2) use of the existing M&NA lines would be less costly, when contrasted to the costs of constructing an entirely new

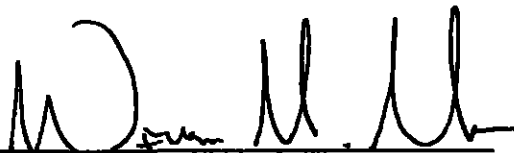
line; and (3) the disruptive nature of an otherwise unnecessary rail construction project (*i e* , in the form of environmental concerns and other interests of the communities through which the construction would traverse) could be avoided.

The Board simply cannot condone a scenario where a railroad lacks the capability to provide dependable rail transportation services to ensure the reliability of a coal plant, yet precludes supplemental service via another carrier that could, at a minimum, mitigate the harm resulting from that railroad's inexcusable service failures. That is precisely what happened at Independence in 1993-1995, 1997-1998 and 2005-2006. Regrettably, ESI and EAI fear that absent Board action in this proceeding, it is just a matter of time before there is another service crisis during which UP will again rely on the anticompetitive terms of its lease with M&NA to preclude supplemental coal deliveries to Independence.

VERIFICATION

STATE OF TEXAS }
 }
COUNTY OF HARRIS } ss:

WILLIAM M. MOHL, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated. Further, I certify that I am qualified and authorized to file this statement.



William M. Mohl

EXHIBIT WMM-1



Customer Communications

Letter From Jack Koraleski

April 15, 2004

To Our Customers:

This is a report to provide you with current information on Union Pacific service issues. Today, we find ourselves in the position of having more business in certain geographic areas than we can handle at this time, and the resulting pressure on our resources has caused a deterioration of service. We recognize that we are failing to satisfy your expectations as well as our own. We know that many of you are concerned about our ability to provide reliable transportation at a time when your business needs are growing. In some cases rapidly.

Here is how we got into this situation:

The problem started with a shortage of train crews. Our manpower plan going into 2003 was developed by analyzing our historic business levels and by surveying our customers to learn their anticipated needs for the upcoming year. We took into account that forecasted economic growth for the prior two years had not materialized. Based on these factors, we made the decision to keep our manpower tight. The year 2003 started out, as had the prior two years, with actual demand substantially below our projections. This continued through the first three quarters and our decision to keep manpower levels tight appeared to be correct. However, unlike 2001 and 2002 when the planned recovery didn't materialize, demand turned quickly upward in the fourth quarter of 2003.

A word about manpower at the railroad. There is a very long lead time from the time an employee is hired until he or she is qualified for train service. New employees must complete classroom and on-the-job training that lasts at least 14 weeks before they can become a brakeman/conductor. Locomotive engineers are drawn from the ranks of experienced conductors and must then complete an additional training program that can take six months. Both positions are subject to stringent federal and company safety rules that limit the amount of time they can be on duty in any given 24-hour period.

This time-consuming process severely limits our ability to ramp up quickly in response to sudden increases in demand and prevents a quick fix. As a result, when the economic recovery actually appeared in the latter part of last year, and demand surged, we could not add qualified crews fast enough – in effect reducing the capacity of our system.

Starting just before the last quarter of 2003, demand began increasing across all our businesses at rates well beyond the high end of our planning, and it accelerated further in the first quarter of this year. For example, we projected that our whole-grain business would increase 5.6% during the first quarter of 2004. We actually handled 9.9% more traffic while demand was up 15.0%. Similarly, lumber shipments were projected to be up 3–4% as we put our plan together, but first quarter demand jumped to the 20–23% range. Our actual performance was 8.5% above first quarter 2003 – about twice the level for which we had planned. One large customer told us to plan on an increase of 6% for this year and its shipments are up 19%. There are many similar examples in all of our business groups where demand was several times higher than predicted. While we are usually pleased with increases in demand, our inability to quickly meet these new levels has become obvious – and is very frustrating.

The combination of a shortage of train crews and the dramatic increase in demand for service created huge stress on our system. This strain manifested itself by increasing the time it takes to recover from external problems such as winter storms and major derailments. While a fully resourced system could recover in a few days from a severe storm such as we experienced in the Pacific Northwest in January or those that followed in the Midwest, it took us several weeks. Usually the disruption from a major service interruption is manageable, however, without a resilient system, the effects are far reaching and time consuming.

With our recovery capacity reduced, our system velocity began to slow late in January. This, in turn, makes the system less efficient and consumes more of our basic resources: crews, locomotives, freight cars, main lines and terminal capacity. As more of these resources are consumed, the system's ability to recover is further degraded, making recovery even more difficult.

Here is what we have done to date to restore our system:

- **We are hiring and training people as fast as we can consistent with maintaining high safety standards.**
Since we began hiring last fall to meet higher demand levels, we have hired over 2,700 people for train service and are on plan to hire an additional 1,250 people in the second quarter alone. In fact, a total of 961 trainmen completed training in the first quarter of 2004 and an additional 397 will graduate in April. Nearly 3,700 people will complete their training and enter train service by September. In the meantime, we also moved employees back into service from other segments of the workforce, shifted qualified employees from surplus areas to areas with shortages, and temporarily borrowed employees from other railroads. New conductors and switchmen are pouring onto the system, but we need to train more conductors to be engineers. A major focus for the next few months will be to qualify more engineers to run our trains.
- **We are acquiring additional locomotives as quickly as they are available.**
Our original plan for 2004 was to acquire 150 new locomotives. In response to the increased demand, we are taking delivery this year on an additional 120 units previously scheduled for 2005. Also, we have leased 300 more units under short-term leases. We are negotiating for an additional 50 similar units, for a total of 620 units. If needed we have the option to pull ahead the delivery of an additional 125 new units. This represents all of the locomotives available on the market this year. Lastly, we are delaying the retirement of older units until we are sure they are no longer needed.
- **We are taking other steps to increase our system velocity.**
We created special Customer Service Centers in the critical locations of Phoenix, AZ, and West Colton, CA. We are building temporary transloading facilities in California and Arizona to keep rail cars out of congested yards, and we are rebuilding a number of tracks in key rail yards to expand their capacity. We are rebuilding one of our rail yards in Los Angeles and reopening our switching yard in Yermo, CA. These actions are allowing us to first recover our fluidity in that region and then to manage the increased demands for service in the West.
- **We are managing the flow of rail cars onto our network.**
We are curtailing several resource intensive trains on our Sunset Corridor between Los Angeles and the East. We are working with a number of customers on switching schedules and other scheduling opportunities as well.

With the current demand for transportation far outstripping the available supply, the most effective tool we have to control volume growth on our railroad is price. As such, we are taking pricing actions to bring supply and demand into balance.

Here is how we are also investing for the future:

- **We are investing for capacity growth.**

We plan to spend approximately \$2 billion of capital this year – an increase of 8% over 2003, including a 68% increase in capacity spending targeting key corridors. We are adding Centralized Traffic Control on our line between Chicago and Omaha, doubletracking more of the Sunset Route, and improving our Chicago–Texas–Mexico capacity.

We'll invest over \$200 million in manifest and intermodal terminals in 2004, an increase of 35% over last year, with projects designed to support growth in many areas of the business.

In fact, Union Pacific has spent \$18 billion of capital since the UP/SP merger to replace rail and ties, add capacity, and to invest in other assets.

Here are the current problem areas:

We confront our greatest challenges in Southern California, the Phoenix and Tucson areas, and throughout the western part of our system, where the crew shortages are greatest. We recently faced a new difficulty across the border in Mexico, where floods washed out a major bridge on Ferromex, south of Eagle Pass, TX. This contributed toward some congestion in the Houston area, although most of our Southern Region is in good shape. We just finished a major track project in Central Texas, which should improve traffic flows to and from Houston. We suffered from two major derailments that crippled us last month in the Midwest. One shut down our Chicago–Omaha main line in Iowa, and it was followed immediately by a derailment that destroyed a bridge on our busy line northwest of Kansas City. Those routes have largely been restored.

In conclusion, we are experiencing record demand that is negatively impacting our velocity and service levels. We are intensely focused on the steps outlined above – hiring and training qualified train crews, acquiring sufficient numbers of locomotives, adjusting our operating plans to reflect increased demand, and investing for future capacity.

We will continue to provide regular updates on our situation so that you can accurately assess our progress. Efficient and timely service is our goal and we look forward to once again achieving this important objective.

A handwritten signature in black ink, reading "Jack Karalinski". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Executive Vice President–Marketing and Sales

Gray V.S.

**VERIFIED STATEMENT
OF
DANIEL B. GRAY**

My name is Daniel B. Gray. I am currently Administrator Coal Transportation for Entergy Services, Inc. ("ESI"). My business address is 10055 Grogan's Mill Road, Parkwood II Building, Suite 300, The Woodlands, TX 77380.

I have been employed by an Entergy company since 1980, when I began my Entergy career with Gulf States Utilities Company (now Entergy Gulf States Louisiana, LLC, and Entergy Texas, Inc.) as a fuel transportation coordinator. In 1983, I was promoted to Director of Fuel Transportation for Gulf States. I held that position until 1993, when Gulf States became a part of the Entergy family. Since 1993, I have been employed by ESI in various capacities. While at ESI, I essentially have performed the same types of transportation functions as I had at Gulf States, although the duties were expanded from responsibility for the Gulf States Nelson coal plant to also include responsibility for Entergy's two Arkansas coal-fired generating plants, the White Bluff Steam Electric Station ("White Bluff") and the Independence Steam Electric Station ("Independence").

In my current position at ESI I am responsible for the day-to-day administration of Entergy's coal transportation arrangements for all of the coal fired generating stations which it operates. These duties include involvement in the procurement, negotiation and administration of the coal transportation

contracts for the three coal-fired generating plants operated by Entergy. I have responsibility for scheduling deliveries, managing trainsets, and coordinating with the railroads, the generating plants and mines to make sure that our trainsets are operating as efficiently as possible. I am also involved in transportation planning activities.

In the course of my duties relating to the Independence Station I have reviewed and become familiar with the 1992 lease agreement between the Union Pacific Railroad Company (“UP”) and the Missouri & Northern Arkansas Railroad (“M&NA”) (*see* Counsel’s Exh. No. 1), elements of which Entergy is challenging through its Complaint in STB Docket No. 42104 and Petition for Revocation of Exemption in STB Finance Docket No. 32187. I am submitting this Verified Statement to provide factual details relating to how the terms of the UP/M&NA Lease have been a serious impediment to Entergy’s ability to obtain all of the coal deliveries that have been needed at the Independence Station since the lease became effective in 1992.

The M&NA/UP Lease Agreement

Since 1983, UP has delivered PRB coal to White Bluff and Independence pursuant a series of coal transportation agreements. Initially the coal was originated by UP and interchanged with the Missouri Pacific Railroad Company (“MP”) at Kansas City. MP then transported the coal via its Carthage Subdivision – which is included in the line currently operated by M&NA – for delivery to

Independence.¹ MP continued to move the coal over this routing from 1983 until 1989, when UP – which by then had acquired control of MP – proposed a reroute of the traffic over its own lines to North Little Rock and then over to Diaz, from which point UP would move over a short stretch of MP trackage to the Independence plant. Entergy agreed to the changed routing based on assurances that service would not be less efficient, along with some contract concessions that were designed to compensate Entergy for the increased mileage on its railcars.

In 1992, UP transferred virtually all of its Carthage Subdivision to M&NA. I have personally reviewed the agreements relating to this transaction in the course of performing my duties for ESI. In total, the line at issue was comprised of about 491 miles of track in Arkansas, Missouri and Kansas. In transferring this line to M&NA, UP sold a 102 mile stretch located in the middle of the Carthage Subdivision between Bergman, Arkansas and Guion, Arkansas, and entered into a long term lease agreement covering the east and west ends. The M&NA/UP lease agreement covers approximately 389 miles of track. On the east end, UP leased the track between Guion and Diaz Junction, Arkansas. On the west end, UP leased the track between Bergman, Arkansas and Pleasant Hill, Missouri, and some connecting branch lines.

After the sale/lease of the Carthage Subdivision to M&NA, UP asked Entergy to consent to the use of M&NA as a subcontractor for performing all

¹ Prior to the execution of the 1983 Agreement, Independence coal was transported pursuant to a tariff arrangement that involved Burlington Northern Railroad Company transporting the coal from PRB origins to Kansas City for interchange to MP, with MP then delivering the coal to Independence

services for UP between Newport, Arkansas and the Independence plant. By agreement dated May 27, 1993, Entergy agreed to this request. See Counsel's Exh. No. 6. This agreement, however, was conditioned on Entergy's right, on seven days' notice to UP, to require UP to resume performance of these services in lieu of M&NA at Entergy's request.

From 1993 through 1998, the Independence coal continued to be routed through North Little Rock and Diaz for interchange to M&NA. During this period, the portion of the Carthage Subdivision west of Independence was not utilized for either empty or loaded coal trains. As explained below, in the Fall of 1997, M&NA moved some empty trains west from Independence to interchange with UP at Kansas City on a temporary basis. In 1998, the carriers adopted this routing for all Independence empties. Currently, M&NA interchanges loaded coal trains with UP at Diaz, Arkansas, delivering the loaded coal trains to Independence for unloading and returning the unloaded coal trains via its line to Kansas City for interchange with the UP.

M&NA maintains interchanges with other railroads, although as others explain and as my experience detailed below has confirmed, the lease contains restrictions that render these interchanges with other carriers ineffective for Entergy's purposes. In particular, there are provisions in the lease that require M&NA to pay UP a "rental" payment that is inversely related to the percentage of traffic it interchanges with carriers other than UP, i.e., the lower the percentage of total traffic that M&NA interchanges with UP, the higher the rent payment that

M&NA must pay to UP. This effectively restricts the amount of traffic that M&NA can economically interchange with carriers other than the UP. M&NA has physical interchanges with the BNSF Railway Company ("BNSF") at Lamar, Aurora, and Springfield, Missouri, as well as Fort Scott, Kansas. M&NA also has physical interchange capability with BNSF and Kansas City Southern Railway Company ("KCS") at Kansas City, and with KCS at Joplin, Missouri.

The 1993-1995 Service Crisis

I first became aware of the restrictive nature of the M&NA/UP Lease Agreement in connection with serious coal delivery shortfalls that Entergy experienced at its Arkansas coal plants in 1994-1995. UP initially blamed these problems on inventory rebuilding following severe flooding in the Midwest that occurred in the summer of 1993. However, it became apparent that other significant factors also contributed to the shortfall including sharp increases in UP coal traffic in 1994 and 1995, questions concerning adequate rail capacity to handle the increased volumes, and difficulties associated with the UP's integration of the newly acquired Chicago & Northwestern Transportation Company. The combination of these events put Entergy's coal deliveries at significant risk throughout 1994 and into 1995. For example, in 1994 alone, UP incurred deficit tonnages to Entergy { [REDACTED] } tons out of a total planned annual volume of 13 million tons.

was lost during this curtailment, Entergy had to resort to purchased power at substantially higher costs than would have been experienced had UP either delivered all the coal that Entergy needed or allowed BNSF/M&NA to deliver supplemental coal to replace the coals that UP was not delivering.

The 1997-1998 Service Crisis

Regrettably, history repeated itself in 1997 and 1998. During the second quarter of 1997 Entergy began noticing that cycle times to Independence were increasing at an alarming rate. The service problems continued through the remainder of 1997 and 1998. Once again, Entergy experienced significant delivery shortfalls exceeding { } tons.² Entergy again curtailed generation at its Arkansas plants in an effort to conserve coal, and was faced with the need to replace lost generation with either alternate coals or other replacement energy sources, such as purchased power, at substantially higher cost to its consumers.

I was involved in the efforts to obtain much-needed supplemental coal deliveries during the 1997-1998 UP service crisis. These efforts were detailed for the Board by Mr. Charles W. Jewell, Jr., then Director of Coal Supply for ESI, in a Verified Statement submitted on October 23, 1997 in Finance Docket No. 32760 and 32760 (Sub-No. 21) (Copy attached as Exhibit DBG-4). I reported to Mr. Jewell in 1997 and was aware of the events Mr. Jewell describes in his statement.

² Entergy sued UP in Federal District Court in Nebraska for breach of contract relating to these delivery shortfalls. The District Court ruled that UP had breached the parties coal transportation agreement in creating deficit tons, and failing to make up those tons. *See Entergy Services, Inc v Union Pacific R R*, 35 F Supp. 2d 746 (D Neb 1999) The case was ultimately settled by the parties in the summer of 2000.

In addition, I participated in the efforts to obtain UP's consent to allow supplemental deliveries via BNSF/M&NA.

As the service crisis dragged on into 1998, Entergy renewed its request to UP for permission to allow BNSF/M&NA to move supplemental coals to Independence. On April 7, 1998, Mr. Jewell asked UP to allow BNSF to use trackage rights that it had obtained in the UP/SP merger so that it could reach Diaz and then interchange trainsets to M&NA. *See* Exhibit DBG-5. Entergy noted that the continuing deficits were causing curtailments and that Entergy was incurring “very substantial additional costs for electricity generation from natural gas and for power purchases.” *Id.* at 2. Even worse, Entergy noted that the delivery shortfalls had Entergy “in a very precarious position with regard to its ability to meet system demands for electricity this coming summer.” *Id.* Despite these dire circumstances, { [REDACTED]

[REDACTED] 3 [REDACTED]

[REDACTED]

[REDACTED]

The 2005-2006 Service Crisis

While service levels were somewhat stable during 2000-2004, Entergy began to see service declines going into the first quarter of 2005. By the Second Quarter of 2005, the declines had once again reached the crisis point. As has been

3 { [REDACTED] }

much-publicized, UP claimed that the disruptions in the delivery chain were the result of a claimed *Force Majeure* event relating to deterioration of track conditions on the PRB Joint Line. UP made clear in public statements, as well as in its direct communications with Entergy, that it was not going to be able to deliver all of the coal that Entergy required under its Coal Transportation Agreement for Independence until rehabilitative maintenance was completed on the Joint Line. Instead, UP announced its intention to ration coal to its PRB shippers while it repaired its lines, and that each shipper would be receiving approximately 85% of its need.

In an effort to mitigate the harms that were being caused by the UP delivery shortfalls – shortfalls that we did not believe were the product of events beyond UP’s control – Entergy again looked at potential alternative sources of coal to replace the UP under-deliveries. Among the alternatives that we looked at was the possibility of moving foreign coals to Independence through the Illinois Central’s Rail Marine Terminal (“ICRMT”) at Convent, Louisiana. There were at least two potential routings available from ICRMT. One involved CN/UP/M&NA, and the other involved CN/KCS/M&NA. Given the significant service issues that UP was experiencing on its system, and that Entergy was using CN/KCS to transport foreign coal to another one of its plants, Entergy decided that it made sense to pursue the CN/KCS/M&NA option.

Discussions with M&NA continued between March and October. { [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] } Because of

the urgent need for supplemental coal, Entergy was forced to abandon discussions

with CN/KCS/M&NA and to deal with UP for the UP/CN/M&NA move.

Unfortunately, it was not until 2007 that we were finally able to move the tons.

Our experience in 2006 with M&NA confirmed, once again, that the absence of an independent M&NA left Entergy in a very precarious position with regard to its ability to meet system demands for electricity during summer peak burn periods. Because of UP's service difficulties, Entergy again – marking the third time since the UP/M&NA lease was executed – had to curtail generation at its Arkansas coal stations in order to conserve coal. For the period from the First Quarter of 2005 through the Fourth Quarter of 2006, UP created deficits of approximately { [REDACTED] } under our rail agreement. Once again, the absence of the ability to supplement coal deliveries, in part due to the UP/M&NA lease restriction, caused Entergy to incur substantial additional costs in order to replace the generation that could have been produced had UP delivered all the coal that Entergy required.⁴

Conclusion

As the above experience reflects, the presence of the paper barrier in the UP/M&NA lease has been a very effective bar to M&NA's ability to interchange traffic with BNSF for delivery of supplemental coals to Independence Station during UP's various service crises. But for this restriction, Entergy could have

⁴ UP and Entergy again found themselves in litigation – this time in State Court in Arkansas. See *Union Pacific R R v Entergy*, No. CV2006-2711, in the Circuit Court of Pulaski County, Arkansas, Sixth Division. UP initially commenced the litigation and requested a declaratory ruling that its performance was excused because of a Force Majeure event. Entergy counterclaimed for breach of contract. The litigation was recently settled in April 2008.

avoided, or at least minimized, the need to curtail generation during each of these service crises, thereby greatly reducing the costs to its consumers.

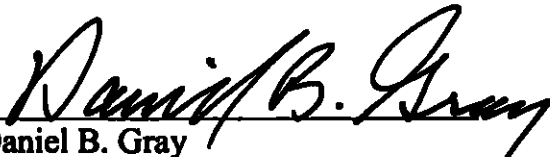
VERIFICATION

STATE OF TEXAS }

COUNTY OF HARRIS }

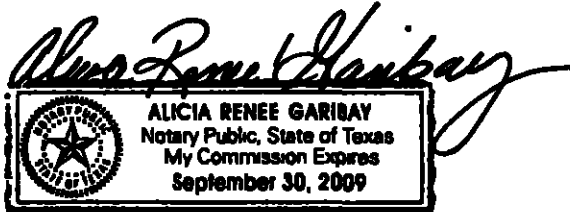
ss:

DANIEL B. GRAY, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated.


Daniel B. Gray

Subscribed and sworn to before me this
9 day of July 2008

My Commission expires September 30, 2009



COUNTY OF MONTEREY, Texas

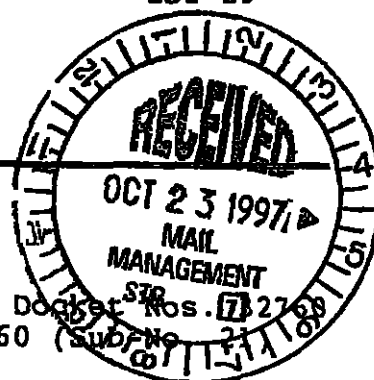
EXHIBIT DGB-1 TO DBG-3

REDACTED

EXHIBIT DGB-4

BEFORE THE
SURFACE TRANSPORTATION BOARD

ESI-29



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

Finance Docket Nos. 2768
and 32760 (Sub No. 2110)

PETITION OF ENTERGY SERVICES, INC.
AND ENTERGY ARKANSAS, INC. FOR
MODIFICATION OF DECISION NO. 44 OR, IN
THE ALTERNATIVE, FOR ADDITIONAL CONDITION

PUBLIC, REDACTED VERSION

ENTERGY SERVICES, INC. and its
affiliate ENTERGY ARKANSAS, INC.

By: O. H. Storey
Deputy General Counsel
Entergy Services, Inc.
Mail Unit L-ENT-26D
639 Loyola Avenue
New Orleans, LA 70113

OF COUNSEL:

Slover & Loftus
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

C. Michael Loftus
Frank J. Pergolizzi
Andrew B. Kolesar III
1224 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 347-7170

Dated: October 23, 1997

Their Attorneys

ENT0506

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	Finance Docket Nos. 32760 and 32760 (Sub-No. 21)
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My name is Charles W. Jewell, Jr. I am the Director,
Coal Supply for Entergy Services, Inc. ("ESI"). My office
address is 10055 Grogans Mill Road, Suite 300, The Woodlands,
Texas 77380.

As Director, Coal Supply for ESI, I am responsible for the acquisition of coal and related transportation for all of the electric utility operating subsidiaries of Entergy Corporation.

Entergy Corporation is an investor-owned public utility holding company registered pursuant to the Public Utility Holding Company Act of 1935. The Entergy operating companies include Entergy Arkansas, Inc. ("Entergy Arkansas", formerly known as Arkansas Power & Light Company); Entergy Gulf States, Inc. (formerly Gulf States Utilities Company); Entergy Louisiana, Inc. (formerly Louisiana Power & Light Company); Entergy Mississippi, Inc. (formerly Mississippi Power & Light Company); and Entergy New Orleans, Inc. (formerly New Orleans Public Service, Inc.). ESI is a wholly-owned subsidiary of Entergy Corporation, and acts as agent for the above-named operating companies in acquiring fuel and related transportation for their coal-fired power plants. In this Verified Statement I will focus in particular on Energy Arkansas.¹

The purpose of this testimony is to provide the Surface Transportation Board ("Board") with facts concerning the present critical situation faced by Entergy as a result of UP's continuing and very severe service problems in transporting coal to Entergy Arkansas' two large coal-fired plants in Arkansas, the White Bluff Steam Electric Station ("White Bluff") and the Independence Steam Electric Station ("Independence"). I will also demonstrate Entergy's need for modification of the White Bluff build-out preservation condition imposed by the Board in granting merger authority to Union Pacific Railroad Company

¹ I will refer to ESI and Entergy Arkansas, Inc. collectively as "Entergy" in my testimony.

("UP") and Southern Pacific Transportation Company ("SP") in 1996. This condition, which I will refer to as the "White Bluff condition", is described in more detail on page 2 of Entergy's accompanying Petition for Modification in this proceeding.

I. BACKGROUND

Entergy Arkansas produces, distributes and sells electric power to approximately 600,000 residential, commercial and agricultural customers located in 63 counties in Arkansas, and also engages in the wholesale power market. Its White Bluff and Independence plants collectively consist of four units (two at each plant), with a combined capacity of approximately 3,337 megawatts. Each plant normally burns approximately 6.5 million tons of coal annually, or 13 million tons in total, all of which is produced in the southern Powder River Basin of Wyoming, and all of which is transported to the plants by rail (specifically, by UP). Entergy's present coal supply and transportation arrangements for the White Bluff and Independence plants are described at pp. 5-8 of the Verified Statement of Roy A. Giangrosso (who was then ESI's Director, Coal Supply) in Entergy's Comments in this proceeding served March 29, 1996.

Entergy's present rail transportation contract with UP, known as the "Interim Agreement", whose term runs through

requires that 100% of the coal

destined to White Bluff and Independence be transported by UP. Unfortunately, the level of service

provided by UP in transporting coal to these plants under the Interim Agreement is abysmal. As I will describe in more detail below, UP is completely failing to meet the service standards set forth in the Interim Agreement, with the result that Entergy is unable to receive all the coal these plants need to meet their generation requirements. Entergy has been forced to curtail burn (and thus generation) at these plants, and either purchase more expensive power from the grid or use more expensive gas generation.

In order to remedy the present situation, which is growing to near-critical proportions due to UP's continuing service crisis in the south-central part of the nation, Entergy must supplement UP's inadequate coal transportation service with transportation by other rail carriers, in particular the Burlington Northern and Santa Fe Railway Company ("BNSF") -- which also serves the PRB mines in Wyoming -- at White Bluff.² It is for this reason that Entergy is requesting the Board to modify the White Bluff condition previously imposed in approving the UP/SP merger to enable BNSF to serve the White Bluff plant immediately, without waiting for construction of the build-out.

² BNSF service to White Bluff would enable UP to concentrate on providing service to Independence.

The build-out involves construction of a 21-mile line to a connection with the former SP Memphis-Houston line at Pine Bluff, AR. BNSF was granted trackage rights over this line as a condition to the UP/SP merger, and the White Bluff condition will enable BNSF to use these trackage rights to access the White Bluff plant after the build-out is completed. It will take approximately three years to construct the build-out, from engineering design to final completion, so completion will not occur until approximately the year 2001. In the interim, without the relief requested herein, Entergy must rely on UP to haul coal to its Arkansas power plants -- a totally unacceptable situation considering UP's failure to meet Entergy's coal delivery requirements.

II. UP'S CONTRACTUAL SERVICE COMMITMENTS

Entergy presently operates 18 trainsets, each consisting of 115 high-capacity aluminum cars acquired by Entergy in 1995, in PRB coal service to the White Bluff and Independence plants. The economics of acquiring and using this equipment are dependent on an assured level of rail service. Thus, Entergy's Interim Agreement with UP (which became effective in 1990) contains a service standard, under which UP has committed to transporting coal from the PRB mines to White Bluff

"Elapsed Transit Time" (excluding specified time for loading coal trains at the mines and unloading them at the plants) of hours in the case of White Bluff and hours in

the case of Independence. If UP fails to meet its
Elapsed Transit Time , it then
has a deficit, which it must make up
. If UP incurs a deficit and
fails to make it up it is obligated to pay
Entergy liquidated damages

UP is also under an express contractual obligation to
exercise good faith in avoiding the creation of deficits. It is
Entergy's position that the make-up and liquidated damages
provisions of the Interim Agreement are not intended to be used
as substitutes for contract transit time requirements in the
chronic, pervasive manner that UP has resorted to in recent
years.³

³ Virtually identical service standards are also contained
in Entergy's original rail transportation contracts with UP and
its then-partner, the Chicago and North Western ("CNW"), and with
Missouri Pacific, which were signed in 1983. These agreements
are also described in Mr. Giangrosso's Verified Statement filed
as part of Entergy's Comments of March 29, 1996.

UP's average Elapsed
Transit Time was hours for coal trains moving to the White
Bluff plant and hours for coal trains moving to the Indepen-
dence plant. These cycle times exceeded the contractual standard
by an average of hours in the case of White Bluff and hours
in the case of Independence.

UP's average Elapsed Transit Times ballooned to hours
for White Bluff and hours for Independence.

these transit times soared even further, to hours and hours, respectively. On average, UP exceeded its contractual service standard by hours, or %. UP exceeded its service standard by an average of hours, or %. UP exceeded its service standard by an average of hours, or %.

These poor cycle times resulted in deficit tonnages -- the volumes of coal by which UP fell short of the quantity it should have transported in the trainsets provided by Entergy had it met its service standard --

. In addition, UP has effectively "rolled over" deficits , and the cumulative deficit stood at about . We are seeing

no improvement in UP's cycle times

and the deficit is growing at an accelerated rate.

As a direct result of UP's dismal performance in transporting coal to the White Bluff and Independence plants, the inventory of coal stockpiled at the plants, which Entergy attempts to keep at a level equal to days' projected coal burn, has rapidly dwindled. At present, the inventory amounts to only days at White Bluff and days at Independence. The reduced inventories, with no prospect of improvement in UP's service, have resulted in Entergy Arkansas' curtailing burn (and thus the generation of electricity) at these plants. As a result, the Entergy system (which is economically dispatched) has had to purchase more expensive power from the grid and shift more generation to its expensive gas-fired plants. Given UP's virtual service meltdown south of Kansas City, which Entergy does not expect UP to be able to remedy in the foreseeable future, the situation is becoming critical for Entergy (and, I understand, for other utilities particularly in Texas).

III. ENTERGY'S ATTEMPTS TO USE ALTERNATE RAIL SERVICE

Entergy has repeatedly informed UP of the vital importance of compliance with its service commitments under the Interim Agreement, and of the worsening situation in terms of inventory and reduced coal burn at the White Bluff and Independence plants. Entergy has had several meetings and conference calls with UP, to no avail. Finally, on September 23, 1997, I

wrote to UP's Senior Vice President in charge of coal marketing and transportation, Art Peters, and informed him that the situation had deteriorated to the point where Entergy believed UP had materially breached its contractual obligations under the Interim Agreement. A copy of my letter to Mr. Peters is attached hereto as Exhibit CWJ-1.

My September 23 letter also requested UP's permission to waive the 100%-volume requirement of the Interim Agreement, and sought UP's cooperation in making alternative transportation arrangements with other carriers, in particular BNSF. Finally, we requested definitive assurances from UP as to its ability to meet its contracted service standard in the future, and indicated that the matter had to be resolved by September 30, 1997.

Mr. Peters did not respond to my September 23 letter until late on October 3, 1997 (after the lawsuit discussed below had been filed). A copy of Mr. Peters' October 3 letter is attached hereto as Exhibit CWJ-2. To say the least, his response did not provide the kind of assurances Entergy had requested

Equally important, Mr. Peters' October 3 letter rejected Entergy's request that UP waive the volume requirements of the Interim Agreement and cooperate with Entergy in arranging alternative transportation service with other carriers to help Entergy through the present crisis.

Given UP's continuing service deterioration⁵ and its refusal to respond in a meaningful way to our requests for cooperation in resolving the present crisis, on October 3, 1997, Entergy filed suit in the United States District Court for the Middle District of Louisiana alleging that UP has materially breached both the Interim Agreement and the underlying 1983 Agreements due to its continuing failure to meet the contractual service standards, and seeking both the right to terminate the agreements and damages. Entergy Services, Inc. and Entergy Arkansas, Inc. v. Union Pacific Railroad Company, Civil No. 97-967-B-M3 filed October 3, 1997. A copy of the complaint in this action is attached hereto as Exhibit CWJ-3.

The modified condition being sought here would remove an impediment to Entergy obtaining effective relief through the federal court action. With the modified condition, Entergy would be able to make alternative transportation arrangements with BNSF.

IV. CONCLUSION

UP's present service difficulties are a direct result of its haste and failure to plan adequately in implementing its merger with SP. Entergy urgently needs the Board's help in

⁵ As an example of how bad things are, on September 29, 1997 one of our trains was released after unloading at the White Bluff plant. UP then took the empty train to Durand, KS, where it arrived on September 30. The train was then parked on a siding and the locomotives removed. This train was finally returned to service on October 11, but other trains either are not moving or have been removed from service from time to time.

obtaining substitute rail service to make up for UP's merger-related inability to keep the White Bluff and Independence plants supplied with coal.

On behalf of Entergy, I respectfully urge the Board to modify the White Bluff build-out condition to enable BNSF to serve the White Bluff plant directly, using its existing trackage rights over the UP line that passes right by the plant, until Entergy is able to construct the build-out.



Entergy Services, Inc.
Parkwood II Building, Suite 300
10055 Grogans Mill Road
The Woodlands, TX 77380
Tel: 281 297 3562

Charles W. Jewell, Jr.
Director
Coal Supply

September 23, 1997

VIA FACSIMILE AND
CERTIFIED MAIL/RETURN RECEIPT REQUESTED

Mr. Art Peters
Senior Vice President
& General Manager
Union Pacific Railroad Company
1416 Dodge Street, Room 500
Omaha, NE 68179

RE: Breach of Railroad's Service Commitments

Dear Mr. Peters:

Entergy Arkansas, Inc. currently receives rail transportation services to its Arkansas coal plants from Union Pacific Railroad Company pursuant to Interim Rail Transportation Agreement ICC-WRPI-C-0065, dated October 1, 1991, which superseded certain provisions of Agreement ICC-UP-C-0505 and Agreement ICC-MP-C-0430. Upon termination of the interim agreement, the terms of Agreements ICC-UP-C-0505 and ICC-MP-C-0430 again are applicable, subject to amendment/renegotiation.

Entergy's coal plants in Arkansas have experienced significant shortages in coal deliveries from Union Pacific. As a result of these delivery shortages and Union Pacific's failure to meet the service standards set forth in the agreement, Entergy, among other things, has been forced to curtail its coal burns, seek alternate fuel sources and purchase electric power from other sources, all to the detriment of Entergy and its ratepayers.

Based on Union Pacific's actions and its inadequate responses to concerns expressed by Entergy representatives, Entergy believes that Union Pacific has breached its contractual obligations under the agreement. Specifically, Entergy believes that Union Pacific, among other things, has failed and refused to abide by the contractual obligations with respect to cycle times, minimum train lading weight and the good faith obligation to avoid creating deficit tonnages.

ENT0536

Mr. Art Peters
Page 2
9/23/97

While the agreement provides for deficit service payments, such payments do not provide an adequate remedy. Union Pacific's persistent and continuing failure to meet its cycle time commitments under the agreement, and its continued failure and refusal to make good faith efforts to avoid deficit tonnages as required by our agreement are unacceptable. Such failure and refusal are causing Entergy substantial and irreparable harm, and constitute a material breach of the agreement. Among other things, and without waiving any other alternatives available to it, given the current near-emergency situation with respect to the coal inventory at the White Bluff and Independence plants, Entergy will explore immediately options (1) with respect to the movement of coal to the Independence plant via Burlington Northern Santa Fe and Missouri & Northern Arkansas Railroads; (2) for the barge delivery of coal to the White Bluff plant, and (3) for the movement of coal via BNSF to Pine Bluff, Arkansas, and thence via Union Pacific to the White Bluff Plant.

Entergy expects that Union Pacific will cooperate with it in every respect in its efforts to make alternative transportation arrangements with alternate providers. You are requested to provide information with respect to any restrictions that may exist with respect to the M&NA's delivery of coal to White Bluff in connection with BNSF, and to waive such restrictions. You are also requested to provide Entergy with a rate for the movement of trainloads of coal in Entergy cars between a point of interchange with BNSF at Pine Bluff, Arkansas, and the White Bluff plant, that can be used in combination with a BNSF rate from the Powder River Basin mines to Pine Bluff.

Additionally, Entergy demands adequate assurances from the Union Pacific as to its ability to meet its cycle time commitments under the agreement from this date forward, and as to its ability to transport all deficit tonnage that has accrued and that will accrue so as to become completely current and remain current. In order to receive adequate assurances with respect to these issues, it will be necessary for Union Pacific to provide documentation sufficient to enable Entergy to perform a due diligence review of Union Pacific's operations with a view toward satisfying itself with reasonable certainty as to Union Pacific's ability to perform in accordance with any such assurances. Entergy expects that Union Pacific will cooperate in making information available for this purpose.

Mr. Art Peters
Page 3
9/23/97

While Entergy will be pursuing these alternatives, it in no way considers these to be the only remedies available to it. Under the circumstances, Entergy intends to evaluate all of its remedies. We plan to resolve this matter no later than September 30, 1997. Please contact me immediately so that we may discuss this matter.

Sincerely,

A handwritten signature in black ink, appearing to read 'CWJ' followed by a long horizontal flourish.

jb

cc: James F. Kenney

bcc: Ms. Kelly Cupero
Mr. Chris Mills, Slover & Loftus
Mr. Bud Storey

EXHIBIT CWJ-2

REDACTED

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF LOUISIANA

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ENTERGY SERVICES, INC. AND
ENTERGY ARKANSAS, INC.,

PLAINTIFFS,

VERSUS

UNION PACIFIC RAILROAD COMPANY,

DEFENDANTS.

CV NO. 97-967-B-M3

C O M P L A I N T

Plaintiffs, Entergy Services Inc. ("ESI") and Entergy Arkansas, Inc. ("Entergy Arkansas") (collectively referred to herein as "Entergy"), complain of defendant Union Pacific Railroad Company ("UP") as follows:

Jurisdiction and Venue

1.

This is a civil action in which the matter in controversy exceeds the sum or value of \$75,000, exclusive of interest and costs, and is between citizens of different states. This Court has jurisdiction of the parties and the subject matter pursuant to 28 U.S.C. § 1332.

2.

Venue is properly in this Court pursuant to 28 U.S.C. §1391(a), because UP resides in this judicial district; UP owns, controls and operates railroad lines and other facilities

approximately 13.0 million tons annually at both plants. All of the coal burned at White Bluff and Independence is produced in the southern Powder River Basin of Wyoming ("PRB") and is transported to White Bluff and Independence by rail.

8.

Since August of 1984, Entergy Arkansas' PRB coal has been transported to its White Bluff and Independence plants pursuant to long-term rail transportation agreements. The first of these agreements was entered by and between Entergy Arkansas, UP, and two UP predecessor companies, Western Railroad Properties, Incorporated ("WRPI") and Chicago and North Western Transportation Company ("CNW"), on July 22, 1983, and provided for the transportation of coal originating in the PRB and destined for Entergy Arkansas' White Bluff and Independence plants (the "UP Agreement"). A related agreement was executed the same day by and between Entergy Arkansas and another UP predecessor company, Missouri Pacific Railroad Company ("MP") (the "MP Agreement"). (The UP Agreement and the MP Agreement are collectively referred to herein as the "1983 Agreements"). The 1983 Agreements became effective upon their approval by the Interstate Commerce Commission ("ICC") pursuant to 49 U.S.C. § 10713, and are identified as Contract Numbers ICC-UP-C-505 and ICC-MP-C-0403.

9.

The UP Agreement provided for the transportation of coal between the PRB mines and Kansas City, Missouri/Kansas; the MP Agreement provided for the transportation of the same coal from

Kansas City, Missouri/Kansas to the White Bluff and Independence plants. Use of both agreements was necessary to provide for the continuous rail carriage of coal from the PRB to the White Bluff and Independence plants.

10.

On October 1, 1991, Entergy Arkansas, UP, WRPI, CNW and MP entered an Interim Rail Transportation Agreement ("Interim Agreement"), ICC-WRPI-C-0065, which was also approved by the ICC. The Interim Agreement is currently in effect. A recent amendment to the Interim Agreement provides that the parties will negotiate market-based rates for the movement of PRB coal to White Bluff and Independence by rail starting in the year 2000.

11.

Both the 1983 Agreements and Interim Agreement set forth the rates, services and other terms and conditions governing transportation of coal by UP between PRB mine origins in Wyoming and the White Bluff and Independence plants. The agreements contain confidential provisions that prohibit disclosure of certain information regarding these agreements, and Entergy has therefore framed in general terms portions of this pleading relating to the agreements.

12.

The 1983 Agreements represented the first agreements entered by UP and WRPI/CNW for the transportation of PRB coal. The first movements under these agreements occurred in August of 1984, when WRPI first instituted service to the PRB mines from which Entergy

Arkansas purchased (and purchases) coal for use in generating electricity at the White Bluff and Independence plants.

13.

Pursuant to the terms of the 1983 Agreements and the Interim Agreement, Entergy Arkansas is obligated to ship, and UP is obligated to transport, a certain minimum volume of coal each year.

14.

Both the 1983 Agreements and the Interim Agreement include a number of provisions that describe UP's commitments concerning the service to be provided in connection with the contract movements to White Bluff and Independence, including but not limited to the following:

- (a) UP has a duty to transport all coal tendered by Entergy Arkansas within a defined average elapsed transit time.
- (b) If UP fails to meet the transit time standard, and as a result, fails to transport the required volume of coal during a defined time period, UP must transport (in its own railcars) the shortfall to Entergy Arkansas within a certain time thereafter. If UP fails to do so, UP must pay a prescribed amount of liquidated damages to Entergy Arkansas.
- (c) UP is expressly obligated to exercise good faith efforts to avoid creating any deficit tonnages.

15.

Among other things, the purpose of the contract provisions described in paragraph 14. herein, is to optimize the productivity

of Entergy Arkansas' railcar fleet and to assure an adequate and continuous supply of coal to maintain electric generation at Entergy Arkansas' White Bluff and Independence plants. As the parties expressly stated in the 1983 Agreements, it was their "desire that the contractual arrangement promote maximum equipment utilization and transportation efficiency and provide all parties with economic incentives."

16.

In reliance on the service standards and other contractual provisions described in paragraphs 14 and 15 herein (collectively referred to herein as "the service standards"), in 1995 Entergy Arkansas replaced its fleet of steel railcars used for the transportation of coal from the PRB to the White Bluff and Independence plants with a fleet of higher-capacity aluminum railcars, and made certain modifications to the coal unloading facilities at both plants, at a total capital cost in excess of \$100 million.

The Controversy

17.

In spite of the stated intent to promote maximum equipment utilization and transportation efficiency, and the obligation to make a good faith effort to avoid creating deficit tonnages, UP has consistently ignored its contractual service commitments to Entergy Arkansas, and has breached, and continues to breach, the service standards by:

- (a) Continually failing to meet the transit time standard.

- (b) Continually failing to comprise trains of the required length.

18.

Entergy has repeatedly informed UP of the vital importance of compliance with the service standards, and the consequent impact of UP's failure to meet these standards on Entergy Arkansas' ability to plan and provide electric utility service to its customers.

19.

Despite Entergy's efforts, UP has refused to either correct the service deficiencies, or provide adequate assurances that it would (or could) take the necessary steps to assure its ability to comply with its contractual service commitments to the end that Entergy is confronted with an escalating deficit in its coal supply which has forced curtailment of power production and reduced reserves to a critical level.

20.

Entergy Arkansas has fully complied with all of its obligations and responsibilities under its contracts with UP.

21.

Under the terms of the 1983 Agreements and the Interim Agreement, Entergy is not free to seek alternative transportation of coal for the White Bluff and Independence plants. Unless Entergy is freed from this restriction, Entergy is precluded from taking action to ensure the reliability of its system, and as a consequence, both Entergy and its customers may suffer irreparable harm.

COUNT I

BREACH OF CONTRACT

22.

Entergy hereby realleges and incorporates by reference ¶¶ 1-21 of this Complaint.

23.

In entering the 1983 Agreements and the Interim Agreement, Entergy Arkansas reasonably expected that UP would substantially perform its contractual promises relating to the service standards, and particularly the stated intent to promote maximum equipment utilization and transportation efficiency and the express commitment to exercise good faith efforts to avoid the creation of deficit tonnages.

24.

Rather than promote maximum equipment utilization and transportation efficiency and exercise good faith, UP has instead persistently failed to meet its duty to comply with the service standards.

25.

UP's persistent failure to meet the service standards has caused, and is continuing to cause, substantial hardship to Entergy and has substantially impaired, and will continue to impair, the ability of Entergy Arkansas to serve its ratepayers.

26.

In entering the 1983 Agreements and the Interim Agreement, Entergy Arkansas relied on UP's agreement to provide service in

accordance with the service standards and did not expect that UP would persistently fail to comply with the service standards.

27.

Entergy also reasonably relied on UP's commitment in the Interim Agreement to exercise good faith to avoid creating deficit tonnages, and reasonably did not expect that UP would engage in a practice of creating and cumulating (rolling over) deficit tonnages in lieu of meeting the contractual elapsed transit time standard.

28.

As a direct and proximate result of UP's failure to meet the service standards, Entergy and Entergy Arkansas have been deprived of maximum equipment utilization and transportation efficiencies in entering the 1983 Agreements and the Interim Agreement.

29.

The liquidated damages remedy contained in the 1983 Agreements and the Interim Agreement was not intended to apply to chronic, pervasive failures to meet the railroad service standards, such as have occurred.

30.

By persistently failing to meet the service standards, UP has materially breached and repudiated the 1983 Agreements and the Interim Agreement.

31.

Entergy has provided UP with an opportunity to cure the above-described breach and UP has exhibited an inability, or unwillingness, to correct the same.

32.

As a direct and proximate result of this breach, Entergy has incurred damages relating to, inter alia, the cost of replacement power, the loss of sales and revenues associated with curtailing production from the plants in question, and other costs and expenses associated with the UP's failure to provide adequate rail transportation service, in an amount in excess of \$1 million.

COUNT II

BREACH OF COVENANT OF GOOD FAITH

33.

Entergy hereby realleges and incorporates by reference ¶¶ 1-32 of this Complaint.

34.

In entering the 1983 Agreements and the Interim Agreement, the parties stated their desire to promote maximum equipment utilization and transportation efficiency and UP expressly committed to exercise good faith to avoid the creation of deficit tonnages.

35.

Under its contractual commitments to Entergy, UP has both an implied and express duty to cooperate with Entergy in order to accomplish the stated objectives set forth in paragraph 34 herein.

36.

UP has refused to comply with the service standards, which were intended to ensure maximum equipment utilization and transportation efficiency, and has been unable, or unwilling, to correct past deficiencies in service.

37.

UP has engaged in a practice of creating and cumulating (rolling over) deficit tonnages, rather than fulfilling its contractual commitment to act in good faith to avoid the creation of such deficit tonnages.

38.

While UP has neglected to comply with its contractual service standards and refused to correct such deficiencies, UP's service to other PRB coal shippers has, in UP's words, "consistently exceeded [UP's] own performance goals and contractual performance commitments...in recent months." Though service to Entergy has continued to deteriorate, UP's "performance levels" for other customers "have reached all-time records." See Applicants' Report on Merger Condition Implementation, Surface Transportation Board Docket No. 32760 (Sub-No. 21), Union Pacific Corporation, Union Pacific Company and Missouri Pacific 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 [OVERSIGHT] at 42 (filed July 1, 1997).

39.

In ignoring and/or refusing to comply with its duty to satisfy the express service standards and stated intent set forth in its contractual commitments to Entergy, while at the same time choosing to provide "record level" service to other PRB coal shippers, UP has breached the covenant of good faith and fair dealing, and has otherwise failed to act in compliance with standards of commercial reasonableness.

40.

As a direct and proximate result of UP's breach of the duty of good faith and fair dealing, Entergy has incurred damages relating to, inter alia, the cost of replacement power, the loss of sales and revenues associated with curtailing production from the plants in question, and other costs and expenses associated with the UP's failure to provide adequate rail transportation service, in an amount in excess of \$1 million; but such monetary damages may be inadequate to fully compensate Entergy for the losses and harm which may be experienced by Entergy and its customers.

PRAYER FOR RELIEF

WHEREFORE, Entergy prays for the following relief:

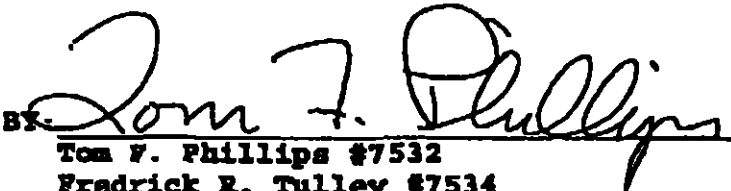
(a) that on the basis of Counts I and II, the Court enter a judgment (i) declaring that UP has materially breached the 1983 Agreements and the Interim Agreement, that because of the material breach those agreements are unenforceable by UP, and that Entergy is excused from performance under those agreements; and (ii)

ordering UP to pay damages relating to the failure to meet the service standards set forth in those agreements;

(b) that the Court, alternatively, order UP to pay all direct, consequential and incidental damages incurred by Entergy as a result of UP's material breach of the 1983 Agreements and the Interim Agreement; and

(c) that the Court award such other and further relief as it deems just and proper.

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**Attorneys for Entergy Arkansas, Inc. and
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VERIFICATION

STATE OF TEXAS)
) SS:
COUNTY OF MONTGOMERY)

Charles W. Jewell, Jr., being duly sworn, deposes and says that he has read the foregoing verified statement, knows the contents thereof, and that the same are true as stated, except as to those statements made on information and belief, and as to those, that he believes them to be true.

CWJ

Subscribed and sworn to before me
this 22 day of October, 1997.

[Signature]

Notary Public for Montgomery County, Texas

My Commission expires 04-17-2001.

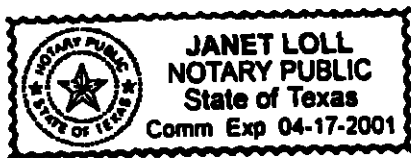


EXHIBIT DGB-5 TO DBG-7

REDACTED

Crowley V.S.

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

	)	
ENTERGY ARKANSAS, INC. and	)	
ENTERGY SERVICES, INC., Complainants	)	
	)	
v.	)	Docket No. 42104
	)	
UNION PACIFIC RAILROAD	)	
COMPANY And MISSOURI &	)	
NORTHERN ARKANSAS RAILROAD	)	
COMPANY, INC. Defendants	)	
	)	
	)	
MISSOURI & NORTHERN ARKANSAS	)	
R.R. – LEASE, ACQUISITION AND	)	
OPERATION EXEMPTION – MISSOURI	)	Finance Docket No. 32187
PACIFIC R.R. and BURLINGTON	)	
NORTHERN R.R.	)	
	)	

I. INTRODUCTION

My name is Thomas D. Crowley. I am an economist and President of L. E. Peabody & Associates, Inc., an economic consulting firm that specializes in solving economic, transportation, marketing, financial, accounting and fuel supply problems. I have spent most of my consulting career of over thirty-seven (37) years evaluating fuel supply issues and railroad operations, including railroad costs, prices, financing, capacity and equipment planning issues. My assignments in these matters were commissioned by railroads, producers, shippers of different commodities, and government departments and agencies. A copy of my credentials are included as Exhibit_(TDC-1) to this opening verified statement ("OVS").

In December 1992, Missouri Pacific Railroad Company and RailTex, Inc., predecessors to Union Pacific Railroad Company ("UP") and Missouri & Northern Arkansas Railroad Company, Inc. ("M&NA") respectively, executed a series of agreements in which: 1) UP leased 389.27 miles of main line and branch lines in the states of Arkansas, Kansas and Missouri to M&NA; 2) UP assigned 30.05 miles of trackage rights over lines of Burlington Northern Railroad Company ("BN") to M&NA; 3) UP granted M&NA 30.3 miles of trackage rights over UP lines; and 4) UP sold to M&NA 102 miles of mainline track from UP extending from Bergman to Guion, Arkansas (herein after these four segments are collectively referred to as the "Carthage Line"). The Lease Agreement provides M&NA full and exclusive use of the leased properties for common carrier rail freight service, including the right to access and interchange traffic directly with all railroads operating at Springfield, Joplin, Carthage, Lamar, Aurora and Nevada, MO and at Fort Scott, KS. Exhibit (TDC-2) in a schematic of the M&NA. The term of the Lease Agreement is 20 years, of which more than 15 years have now expired. At M&NA's discretion the Lease Agreement may be extended three times for an additional 20 years for each extension.

M&NA's right to interchange traffic with other carriers at the locations listed in the previous paragraph is conditioned upon an annual rental payment contained in Section 4 of the Lease Agreement, whereby, M&NA owes an annual rental payment to UP of up to \$90 0 million. The amount of the rental payment is dependent upon the percentage of received or forwarded traffic M&NA interchanges with UP rather than an alternative connecting carrier.

As discussed in a subsequent section of this testimony, the Surface Transportation Board ("STB") decided ¹ to examine interchange limiting provisions such as the rental payment (which are

¹STB decision in Ex Parte 575 (Sub-No. 1), *Review of Rail Access on Competitive Issues – Renewed Petition of the Western Coal Traffic League*, served October 30, 2007 ("Rail Access").

contained in the UP/M&NA Lease Agreement) on a case-by-case basis to ascertain the reasonableness of a specific provision. The standard set forth in Rail Access contemplates that reasonableness will be determined based upon an examination of the net present value ("NPV") of the contribution resulting from a line sale or lease transaction compared with the expected contribution had the transaction not occurred.

I have been asked by Counsel for Entergy Arkansas, Inc. ("EAI") and Entergy Services, Inc. ("ESI") (collectively referred to as "Entergy") to determine: 1) if the NPV of the stream of revenue contribution resulting from the Lease/Sale Transaction is greater than the NPV of the contribution which UP would have received had it not entered the Lease/Sale Transaction with M&NA; and 2) if the rental payment included in Section 4 of the Lease Agreement exceeds the contribution UP would have received had it not entered into the Lease/Sale Transaction.

My testimony is discussed further below under the following topical headings:

II. Background

III. The NPV of the Revenue Contribution Resulting from the Lease/Sale Transaction Exceeds That Which UP Would Have Received Had It Not Entered Into The Lease/Sale Transaction

IV. The Section 4 Rental Payments Would Overcompensate UP For the Impact of Traffic Diversion

V. Conclusions

II. BACKGROUND

The Carthage Line extends from Kansas City, Missouri to Diaz Junction, Arkansas. The traffic moved by M&NA on this rail line is primarily coal traffic terminating at Entergy's Independence Generating Station located at Newark, Arkansas and at Kansas City Power & Light's Montrose Generating Station, located at Ladue, Missouri. Based on information provided by UP in discovery, M&NA received or delivered an annual average of { } carloads of traffic from or to UP during the ten year period 1998 through 2007. Of these carloads, { }, or nearly { } percent, were carloads of coal terminating at either the Independence or Montrose Stations. The remaining { } carloads consisted primarily of { }.

The Lease Agreement contains a rental provision which effectively creates an interchange limiting provision or "paper barrier" through an annual rent schedule that varies with the percentage of annual traffic that M&NA interchanges with carriers other than UP. The rental payment schedule provides that M&NA owes no rental payment if it interchanges between 95 and 100 percent of all traffic with UP, but charges increasing annual rental amounts to M&NA as the percentage of traffic interchanged with UP decreases. The rental payment schedule contained in Section 4.03 of the Lease Agreement is set forth in the Table 1 below.

Table 1		
<u>Lease Agreement Annual Rental Payments</u>		
	<u>Percentage of the Total Traffic That MNA Interchanges with UP</u>	<u>Annual Rent Due UP (December 2002 Levels)</u>
	(1)	(2)
1	100 - 95%	\$ -0-
2.	94 - 85%	\$10,000,000
3.	84 - 75%	\$20,000,000
4.	74 - 65%	\$20,000,000
5	64 - 55%	\$30,000,000
6	54 - 45%	\$40,000,000
7	44 - 35%	\$50,000,000
8	34 - 25%	\$60,000,000
9.	24 - 15%	\$70,000,000
10	14 - 5%	\$80,000,000
11.	0 - 4%	\$90,000,000

As shown in the Table 1 above, if M&NA interchanges 96 to 100 percent of its traffic with a railroad other than UP, it owes UP an annual rental payment of \$90 million.² Further, according to Section 4.01 of the Lease Agreement, the rental payments shown in the Table 1 above apply separately and simultaneously to the interchange locations on both the Pleasant Hill to Bergman and

²The rental amounts shown in Table 1 above are subject to escalation each year in accordance with the "Producer Price Index – Finished Goods", pursuant to Section 4.04 of the Lease/Sale Agreement. As of December 2007 the maximum annual rental amount under the Lease equaled \$114 million.

Guion and Diaz ends of the Carthage Line. For example, if on one end of the M&NA line 20 percent of the eligible traffic is interchanged with UP and at the other end of the line 80 percent of eligible traffic is interchanged with UP, then the rental payment which applies is that percentage which produces the larger rental payment.

III. THE NPV OF THE REVENUE CONTRIBUTION RESULTING FROM THE LEASE/SALE TRANSACTION EXCEEDS THAT WHICH UP WOULD HAVE RECEIVED HAD IT NOT ENTERED INTO THE LEASE/SALE TRANSACTION

In Rail Access, the STB confirmed that it will consider the reasonable nature of pre-existing paper barriers in a lease or sale agreement among Class I carriers and shortline railroads. In its discussion of the interchange limiting provisions in Rail Access, the STB stated:

“But a carrier considering a line sale or lease of a line with traffic that makes a revenue contribution presumably calculates the net present value of the stream of revenue contribution from the traffic it would be forgoing and either (a) demands an equivalent value in the sale price or rental fee, or (b) includes interchange limiting provisions in the sale or lease. The revenue stream resulting from the agreement should be no more than what the carrier would have received had it not divested or leased the rail facilities in question, or had it demanded more in the sale price or rental fee. So long as that is the case, the interchange limiting provisions would not overcompensate the carrier and may shift the risk of unexpected traffic loss to the selling or leasing (Class I) carrier – the party that was more able to assume the risk”³

Based on the above statement, I calculated the NPV of the revenue contribution resulting from the Lease/Sale Transaction and determined that this amount exceeds what UP would have received had it not entered into the transaction.⁴ My examination was made using three different analyses and in each of the analyses, the NPV of the revenue contribution resulting from the Lease/Sale Transaction exceeds that which UP would have received had it not entered the agreements with M&NA.

³Rail Access at 10-11.

⁴As shown below this holds true even when 100 percent of traffic is interchanged with UP and no rental payment is owed UP.

The three analyses that I conducted are: 1) UP's October 1992 analysis of the NPV of cash flows associated with the Lease/Sale Transaction, { }⁵; 2) UP's October 1992 analysis { }; and 3) the NPV of the cash flows associated with the actual historic traffic that has moved under the Lease/Sale Transaction through 2007. Each of these analyses is discussed below.

A. UP'S OCTOBER 1992 ANALYSIS, {

}—

In response to Entergy's discovery requests, UP provided an economic analysis of the after-tax NPV of cash flows based on its expectations of the going concern value of continuing to move the traffic itself compared with the cash flows from entering the Lease/Sale Transaction. UP's analysis assumed that {

}⁶ UP's analysis shows that at the time of the transaction, UP expected the NPV of cash flows from the Lease/Sale Transaction, {

}⁷

⁵This analysis was performed by UP in October 1992, when evaluating whether or not it should enter the Lease/Sale Transaction. UP's analysis was provided in response to Entergy's discovery requests.

⁶The Lease Agreement provides that UP can choose to serve the Independence plant directly via trackage rights over the leased line rather than interchanging the traffic to the M&NA for delivery to the destination. Under this option, UP is obligated to pay M&NA an annual trackage rights fee of \$60,000.

⁷UP's analysis, shown on discovery document UP-IIC-0000304, is included as Exhibit_(TDC-3) to this OVS.

**B. UP'S OCTOBER 1992
ANALYSIS, {**

}

As stated above, UP's analysis of the NPV of cash flows {

}.⁸ To demonstrate the value of the Lease/Sale Transaction as implemented by the parties, I have revised UP's analysis to { }. My calculations rely on UP revenue and cost information for Entergy's traffic which UP provided in discovery in this proceeding and UP's economic model.⁹

This analysis shows that at the time of the transaction, the NPV of expected cash flows from the Lease/Sale Transaction. {

}, which exceeded UP's expected contribution from continuing to move the traffic of {

}.¹⁰

In addition, the annual rental payment (i.e., the interchange limiting provision) contained in the Lease Agreement of up to \$90 million is {

⁸As demonstrated in the previous section of this OVS, {

⁹{ }.

}.

¹⁰Exhibit_(TDC-4) provides a description of the development of the NPV of UP's cash flows from the Lease/Sale Agreement and UP's contribution had it not entered into the Lease/Sale Agreement.

}¹¹ UP would have expected to earn in the first year had it not entered into the Lease/Sale Transaction with M&NA.

C. NPV ANALYSIS BASED ON ACTUAL HISTORIC TRAFFIC (12/92 - 2007)

Both of the above analyses examine the NPV of cash flows based on information that was available to UP at the time UP entered into the Lease/Sale Transaction with M&NA. The analysis contained in this section of my OVS examines the NPV of cash flows using actual historic traffic levels. Specifically, I determined the NPV of UP's cash flows based on the actual traffic that moved over the M&NA during the December 1992 through 2007 time period. This analysis is based on the traffic and revenue data provided by UP in discovery for all traffic moving over the M&NA during this period. Using UP's traffic data, I identified carloads and UP's net revenue from traffic interchanged with M&NA for each year during this historical fifteen year period. I then developed UP's URCS cost of serving this traffic.¹² Using UP's economic model as a framework, I then determined the NPV of UP's actual cash flows from the Lease/Sale Transaction.¹³

The NPV of UP's cash flows from traffic interchanged with M&NA during December 1992 through 2007 time period equals { }¹⁴ {

¹¹Exhibit (TDC-4), Attachment 1, page 3, line 15.

¹²The traffic and revenue data provided by UP contained numerous omissions and deficiencies. For example, nearly 75 percent of the movement records for the five year period 1993 through 1997 contained very limited movement characteristics. The missing movement characteristics had to be estimated from the characteristics available from other complete movement records in the traffic data provided by UP. Exhibit (TDC-5) to this OVS provides a description of the process utilized to estimate the missing movement data and to develop UP's costs of serving this traffic.

¹³Exhibit_(TDC-4) also includes a description of the development of the NPV of UP's cash flows using the actual historic data.

¹⁴Exhibit (TDC-4), Attachment 1, page 5, line 11

}¹⁵ { }. In both instances the NPV of cash flows already achieved by UP substantially exceeds UP's expected contribution from this traffic.

Table 2 below compares the NPV of cash flows for both UP going concern values and from the Lease/Sale Agreement to the NPV of actual cash flows using UP historical data.

Table 2 Net Present Value of Cash Flows From Traffic Moving on the M&NA (dollars in thousands)				
{				
<u>Item</u>				
(1)	(2)		(3)	
1 Going Concern Value	{ }	^{1/}	{ }	^{2/}
2. Lease/Sale – 1992 Perspective	{ }	^{1/}	{ }	^{2/}
3 Lease/Sale – Actual historic data	{ }	^{4/}	{ }	^{5/}
^{1/} Exhibit_(TDC-3), UP Analysis – document UP-HC-0000304 ^{2/} Exhibit_(TDC-4), Attachment 1, page 3, Line 22, Column (2) ^{3/} Exhibit_(TDC-4), Attachment 1, page 4, Line 11, Column (2) ^{4/} Exhibit_(TDC-4), Attachment 1, page 5, Line 11, Column (2) ^{5/} Exhibit_(TDC-4), Attachment 1, page 6, Line 11, Column (2)				

¹⁵Exhibit_(TDC-4), Attachment 1, page 6, line 11.

IV. THE SECTION 4 RENTAL PAYMENTS WOULD OVERCOMPENSATE UP FOR THE IMPACT OF TRAFFIC DIVERSION

In *Rail Access*, STB stated:

“The revenue stream from an agreement should be no greater than what the carrier would have received had it not divested or leased the rail facilities in question, or had it demanded more in the sale price or rental fee. So long as that is the case, the interchange limiting provision would not overcompensate the carrier...”¹⁶

As summarized in Table 2 above, UP’s cash flows from the Lease/Sale Transaction exceed those UP would have received had it not entered into the Lease/Sale Transaction, even though M&NA has interchanged virtually 100 percent of all traffic with UP. Stated differently, M&NA has never made a rental payment to UP.

To further examine the reasonableness of the annual rental payment amounts, I calculated the cash flows assuming three different scenarios which hypothesize situations where M&NA interchanges a portion of the traffic to a carrier other than UP and thereby incurs a rental payment specified in the Lease Agreement. These three scenarios are: 1) all Entergy traffic is received by M&NA from a railroad other than UP; 2) all KCPL traffic is received by M&NA from a railroad other than UP; and 3) all non-unit coal train traffic currently interchanged with UP where UP is a bridge or overhead carrier is diverted to a carrier other than UP.¹⁷ As shown below, the cash flows (including the associated rental payments) resulting from each of these scenarios exceed those UP would have received had it not entered into the Lease/Sale Transaction. The results of each of these

¹⁶*Rail Access*, at p.10.

¹⁷Each of the three scenarios is examined based on information available to UP in 1992 when the Lease Agreement was drafted and executed rather than based on actual traffic since December 1992.

three scenarios are not additive because the resulting rental payment from each scenario is not additive. For example, if both Entergy and KCPL traffic were diverted to a railroad other than UP, the larger of the two resulting rental payments would apply rather than the sum of both rental payments.

A. ENTERGY TRAFFIC

The first scenario assumes that all of Entergy's traffic is received by M&NA in interchange from a carrier other than UP. To calculate the cash flows associated with this scenario, I removed from the cash flow model UP's revenues and "off-branch" cost associated with the Entergy traffic and inserted into the cash flow model the resulting rental payment M&NA would have paid to UP.

Pursuant to Section 4.03 of the Lease Agreement, the rental payment is based on the percent of eligible traffic interchanged with UP at interchange locations "separately and simultaneously" on both the Pleasant Hill to Bergman and Guion to Diaz ends of the Carthage Line. The Entergy traffic is interchanged to M&NA at Newport, Arkansas which is located on the Guion to Diaz end of the Carthage Line. Based on the UP 1993 traffic data, { } carloads were interchanged between UP and M&NA at Newport, { } of which were carloads moving to Entergy. The remaining { } carloads, or { } percent of the total carloads interchanged on the Guion to Diaz end of the rail line, would continue to be interchanged with UP under this scenario.

The resulting annual rental payment M&NA would incur based on this scenario is {

}.¹⁸ See Table 1 above.

¹⁸If the Entergy traffic were diverted in 2007, the M&NA would incur an annual rental obligation of { }. Based on UP's 2007 traffic data, { } carloads were interchanged between UP and M&NA at Newport, { } of which were moving to Independence and { } or { } percent were moving to or from other locations, thus triggering the base annual rental

Under the Entergy scenario, the NPV of UP's after-tax cash flow would equal { } which exceeds the NPV of the after-tax cash flow UP would have received by { } million had UP not entered into the Lease/Sale Transaction.¹⁹

**B. KCPL
TRAFFIC**

The second scenario assumes M&NA receives all of KCPL's traffic in interchange from a railroad other than UP. To calculate the cash flows based on this assumption, the revenues and off-branch costs associated with the KCPL traffic were removed from the cash flow model and the annual rental payments M&NA would incur were inserted into the model.²⁰

The KCPL traffic is interchanged from UP to M&NA on the Pleasant Hill to Bergman end of the rail line. According to UP's traffic data, { } carloads of KCPL Montrose traffic out of a total of { } carloads interchanged from UP to M&NA on the Pleasant Hill to Bergman end of the rail line in 1993. Assuming the remaining { } carloads or { } percent of eligible carloads continued to be interchanged between UP and M&NA, M&NA would incur an annual rental payment of { } under this scenario in December 1992 dollars.

obligation of { }. The base annual rental obligation is adjusted annually based on the change in the Producer Price Index – Finished Goods. The change in this index, applied to the base annual rental is as follows: { }.

¹⁹The calculation of the { } is shown on page 1 of Exhibit_(TDC-6). The expected contribution (including Entergy's traffic) had UP not entered into the Lease/Sale Transaction equals { } (Attachment 1 to Exhibit_(TDC-4), page 3). The difference equals { }.

²⁰The cash flow model used in this analysis is based on information known by UP at the time of the transaction and the revenue and off-branch cost information used is that derived from UP's document UP-HC-0014325. { }, which is the basis for UP's analysis and therefore used in my analysis.

Under the KCPL scenario, the NPV of UP's after-tax cash flow would equal { } which exceeds the NPV of the after-tax cash flow UP would have received had it not entered into the Lease/Sale Transaction by { }.²¹

C. UP BRIDGE TRAFFIC

The final scenario assumes that traffic, which is not originated or terminated by UP (i.e. non-unit coal train traffic where UP acts as bridge or overhead carrier and interchanges with both M&NA and a third carrier) would be diverted to interchange with a carrier other than UP. The traffic data provided by UP in discovery shows that in 1993 M&NA moved a total of { } carloads of traffic in interchange with UP that were not Entergy or KCPL coal shipments. Of these carloads, { } or { } percent were bridge traffic to UP. Of the remaining non-unit coal train carloads, { } carloads moved to interchange on the Pleasant Hill to Bergman end of the line and { } carloads moved to interchange on the Guion to Diaz end of the line.

Assuming M&NA continued to interchange with UP all non-unit train carloads which originated or terminated on UP and also interchanged all of Entergy's and KCPL's carloads with UP, then M&NA would interchange { } percent²² of carloads eligible for interchange on the Pleasant Hill to Bergman end of the line with UP and { } percent²³ of the carloads eligible on the Guion to Diaz

²¹The calculation of the { } is shown on page 2 of Exhibit_(TDC-6). The expected contribution (including Entergy's traffic) had UP not entered into the Lease/Sale Transaction equals { } (Attachment 1 to Exhibit_(TDC-4), page 3). The difference equals { }.

²²{ } KCPL carloads plus { } non-unit train carloads originating or terminating on UP) - { } total carloads available for interchange at Pleasant Hill end of line equals { } percent. See electronic workpaper "cars by interchange.xls".

²³{ } Entergy carloads plus { } non-unit train carloads originating or terminating on UP) - { } total carloads available for interchange at the Diaz end of the line equals { } percent. See electronic workpaper "cars by interchange.xls".

end of the line with UP. As the Lease Agreement specifies that the rental payments apply “separately and simultaneously” to both ends of the line, the annual rental payment incurred by M&NA under this scenario would equal the higher of the rental amounts based on the interchange percentages for the Pleasant Hill end of the line and the Guion to Diaz end of the line. Since both percentages trigger a rental amount of { } that would be the annual rental amount.

The NPV of UP’s after-tax cash flows under this scenario would equal { } which exceeds the NPV of the after-tax cash flow UP would have received by { } had UP not entered into the Lease/Sale Transaction.²⁴

Table 3 below summarizes the amount that the after-tax cash flows, including the annual rental payment, resulting from each of the three hypothetical traffic diversion scenarios exceeds UP’s after-tax cash flow assuming UP had not entered into the Lease/Sale Transaction

²⁴The calculation of the { } is shown on page 3 of Exhibit_(TDC-6). The expected contribution (including Entergy’s traffic) had UP not entered into the Lease/Sale Transaction equals { } (Attachment 1 to Exhibit_(TDC-4), at page 3). The difference equals { }.

Table 3
NPV of UP After-Tax Cash Flows
Resulting From Traffic Diversion Scenarios
(dollars in millions)

<u>Diversion Scenario</u> (1)	<u>M&NA, A Railroad Other Than UP and Rental Payment</u> (2)	<u>UP Cash Flow Of Going Concern Value ^{1/}</u> (3)	<u>Difference ^{2/}</u> (4)
1. Entergy	{ } ^{3/}	{ }	{ }
2. KCPL	{ } ^{4/}	{ }	{ }
3. UP Bridge Traffic	{ } ^{5/}	{ }	{ }

^{1/} Table 2, Line 1, Column (3)

^{2/} Column (2) minus Column (3)

^{3/} Exhibit_(TDC-6), page 1, Line 11, Column (2)

^{4/} Exhibit_(TDC-6), page 2, Line 11, Column (2)

^{5/} Exhibit_(TDC-6), page 3, Line 11, Column (2)

As explained by UP Witness Warren Wilson, {

}.²⁵ {

} the NPV of after-tax cash flows including the annual rental payments substantially exceeds UP's cash flows on a going concern basis for each of the scenarios analyzed.

²⁵{

}.

V. CONCLUSIONS

The NPV of UP's after-tax cash flows resulting from the Lease/Sale Transaction is greater than the NPV of the contribution which UP would have received had UP not entered into the Lease/Sale Transaction. This statement holds true based on UP's own analysis performed prior to the execution of the Lease/Sale Transaction and also holds true when UP's analysis is revised to incorporate its revenue and cost associated with Entergy's traffic. Further, the NPV of the after-tax cash flows UP has actually realized since the execution of the Lease/Sale Transaction exceeds the NPV of the after-tax cash flows from the traffic that UP would have realized had it not entered into the Lease/Sale Transaction.

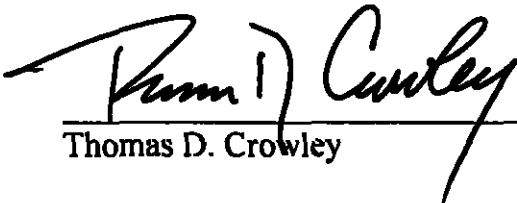
In addition, the NPV of the after-tax cash flows including the annual rental payment, assuming each of the three different hypothetical traffic diversion scenarios, exceeds the NPV of the after-tax cash flows which UP would have received had it not entered into the Lease/Sale Transaction. {

}).

VERIFICATION

STATE OF VIRGINIA }
 }
COUNTY OF ALEXANDRIA }

THOMAS D. CROWLEY, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated. Further, I certify that I am qualified and authorized to file this statement.



Thomas D. Crowley

STATEMENT OF QUALIFICATIONS

My name is Thomas D. Crowley. I am an economist and President of the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, Virginia 22314, and 10445 N. Oracle Road, Suite 151, Tucson, Arizona 85737.

I am a graduate of the University of Maine from which I obtained a Bachelor of Science degree in Economics. I have also taken graduate courses in transportation at George Washington University in Washington, D.C. I spent three years in the United States Army and since February 1971 have been employed by L. E. Peabody & Associates, Inc.

I am a member of the American Economic Association, the Transportation Research Forum, and the American Railway Engineering and Maintenance-of-Way Association.

The firm of L. E. Peabody & Associates, Inc. specializes in analyzing matters related to the rail transportation of coal. As a result of my extensive economic consulting practice since 1971 and my participating in maximum-rate, rail merger, service disputes and rule-making proceedings before various government and private governing bodies, I have become thoroughly familiar with the rail carriers that move coal over the major coal routes in the United States. This familiarity extends to subjects of railroad service, costs and profitability, railroad capacity, railroad traffic prioritization and the structure and operation of the various contracts and tariffs that historically have governed the movement of coal by rail.

STATEMENT OF QUALIFICATIONS

As an economic consultant, I have organized and directed economic studies and prepared reports for railroads, freight forwarders and other carriers, for shippers, for associations and for state governments and other public bodies dealing with transportation and related economic problems. Examples of studies I have participated in include organizing and directing traffic, operational and cost analyses in connection with multiple car movements, unit train operations for coal and other commodities, freight forwarder facilities, TOFC/COFC rail facilities, divisions of through rail rates, operating commuter passenger service, and other studies dealing with markets and the transportation by different modes of various commodities from both eastern and western origins to various destinations in the United States. The nature of these studies enabled me to become familiar with the operating practices and accounting procedures utilized by railroads in the normal course of business.

Additionally, I have inspected and studied both railroad terminal and line-haul facilities used in handling various commodities, and in particular unit train coal movements from coal mine origins in the Powder River Basin and in Colorado to various utility destinations in the eastern, mid-western and western portions of the United States and from the Eastern coal fields to various destinations in the Mid-Atlantic, northeastern, southeastern and mid-western portions of the United States. These operational reviews and studies were used as a basis for the determination of the traffic and operating characteristics for specific movements of coal and numerous other commodities handled by rail.

STATEMENT OF QUALIFICATIONS

I have frequently been called upon to develop and coordinate economic and operational studies relative to the acquisition of coal and the rail transportation of coal on behalf of electric utility companies. My responsibilities in these undertakings included the analyses of rail routes, rail operations and an assessment of the relative efficiency and costs of railroad operations over those routes. I have also analyzed and made recommendations regarding the acquisition of railcars according to the specific needs of various coal shippers. The results of these analyses have been employed in order to assist shippers in the development and negotiation of rail transportation contracts which optimize operational efficiency and cost effectiveness.

I have developed property and business valuations of privately held freight and passenger railroads for use in regulatory, litigation and commercial settings. These valuation assignments required me to develop company and/or industry specific costs of debt, preferred equity and common equity, as well as target and actual capital structures. I am also well acquainted with and have used the commonly accepted models for determining a company's cost of common equity, including the Discounted Cash Flow Model ("DCF"), Capital Asset Pricing Model ("CAPM"), and the Farma-French Three Factor Model.

Moreover, I have developed numerous variable cost calculations utilizing the various formulas employed by the Interstate Commerce Commission ("ICC") and the Surface Transportation Board ("STB") for the development of variable costs for common carriers, with particular emphasis on the basis and use of the Uniform Railroad Costing System ("URCS") and its predecessor, Rail

STATEMENT OF QUALIFICATIONS

Form A I have utilized URCS/Rail form A costing principles since the beginning of my career with L. E. Peabody & Associates Inc. in 1971.

I have frequently presented both oral and written testimony before the ICC, STB, Federal Energy Regulatory Commission, Railroad Accounting Principles Board, Postal Rate Commission and numerous state regulatory commissions, federal courts and state courts. This testimony was generally related to the development of variable cost of service calculations, rail traffic and operating patterns, fuel supply economics, contract interpretations, economic principles concerning the maximum level of rates, implementation of maximum rate principles, and calculation of reparations or damages, including interest I presented testimony before the Congress of the United States, Committee on Transportation and Infrastructure on the status of rail competition in the western United States. I have also presented expert testimony in a number of court and arbitration proceedings concerning the level of rates, rate adjustment procedures, service, capacity, costing, rail operating procedures and other economic components of specific contracts.

Since the implementation of the Staggers Rail Act of 1980, which clarified that rail carriers could enter into transportation contracts with shippers, I have been actively involved in negotiating transportation contracts on behalf of coal shippers. Specifically, I have advised utilities concerning coal transportation rates based on market conditions and carrier competition, movement specific service commitments, specific cost-based rate adjustment provisions, contract reopeners that recognize changes in productivity and cost-based ancillary charges. I have also reviewed,

STATEMENT OF QUALIFICATIONS

analyzed and evaluated both UP's Circular 111 and BNSF 90068 rate levels and other terms and conditions on behalf of coal shippers.

I have been actively engaged in negotiating coal supply contracts for various users throughout the United States. In addition, I have analyzed the economic impact of buying out, brokering, and modifying existing coal supply agreements. My coal supply assignments have encompassed analyzing alternative coals to determine the impact on the delivered price of operating and maintenance costs, unloading costs, shrinkage factor and by-product savings

I have developed different economic analyses regarding rail transportation matters for over sixty (60) electric utility companies located in all parts of the United States, and for major associations, including American Paper Institute, American Petroleum Institute, Chemical Manufacturers Association, Coal Exporters Association, Edison Electric Institute, Mail Order Association of America, National Coal Association, National Industrial Transportation League, North America Freight Car Association, the Fertilizer Institute and Western Coal Traffic League. In addition, I have assisted numerous government agencies, major industries and major railroad companies in solving various transportation-related problems.

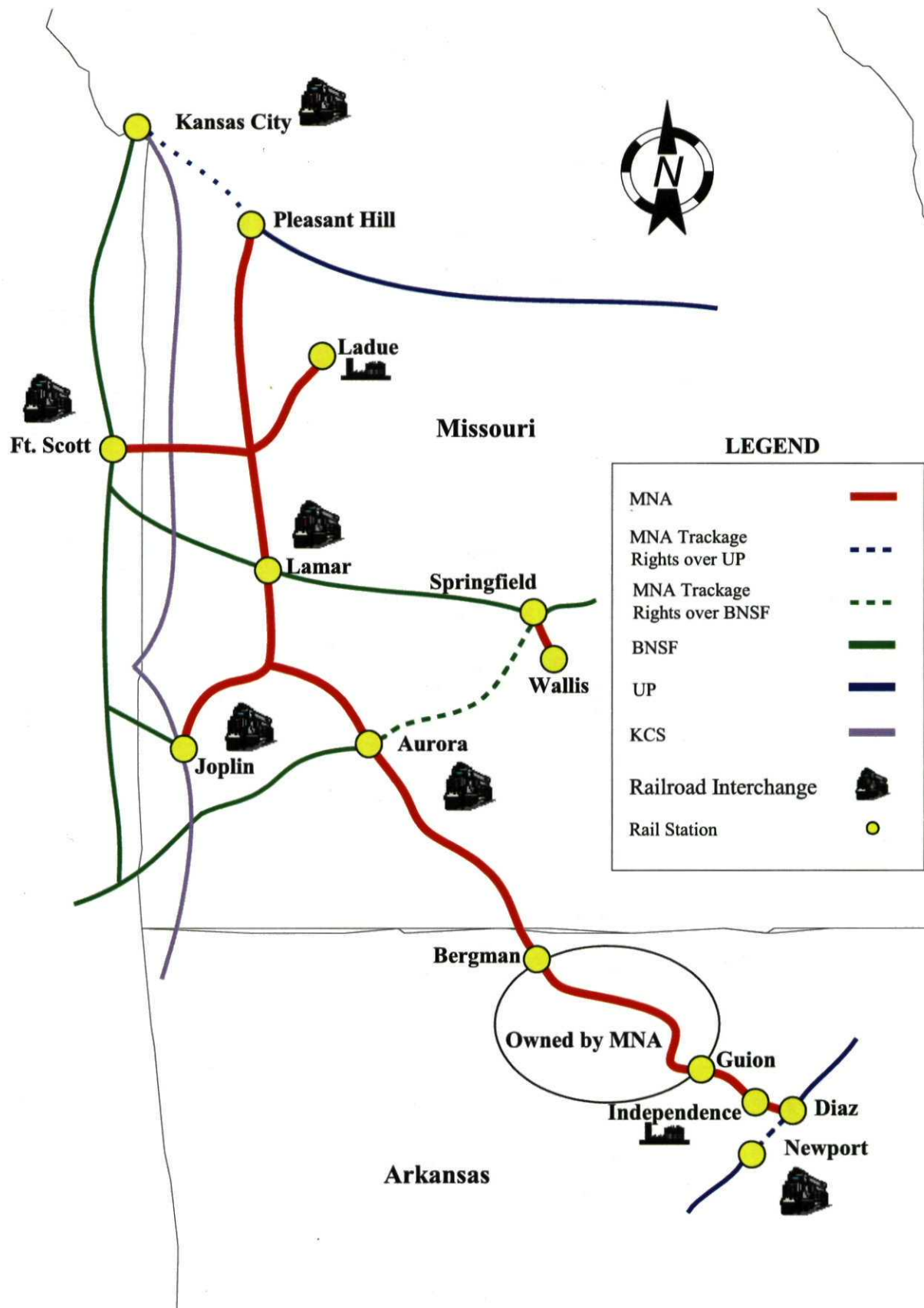
In the two Western rail mergers that resulted in the creation of the present BNSF Railway Company and Union Pacific Railroad Company and in the acquisition of Conrail by Norfolk Southern Railway Company and CSX Transportation, Inc., I reviewed the railroads' applications including their supporting traffic, cost and operating data and provided detailed evidence supporting

STATEMENT OF QUALIFICATIONS

requests for conditions designed to maintain the competitive rail environment that existed before the proposed mergers and acquisition. In these proceedings, I represented shipper interests, including plastic, chemical, coal, paper and steel shippers.

I have participated in various proceedings involved with the division of through rail rates. For example, I participated in ICC Docket No. 35585, Akron, Canton & Youngstown Railroad Company, et al v Aberdeen and Rockfish Railroad Company, et al which was a complaint filed by the northern and mid-western rail lines to change the primary north-south divisions. I was personally involved in all traffic, operating and cost aspects of this proceeding on behalf of the northern and mid-western rail lines. I was the lead witness on behalf of the Long Island Rail Road in ICC Docket No. 36874, Notice of Intent to File Division Complaint by the Long Island Rail Road Company.

Schematic of M&NA



**EXHIBITS TDC-3 TO TDC-6
REDACTED**

Kwoka/Warren-Boulton V.S.

VERIFIED STATEMENT

**John E. Kwoka, jr.
Frederick R. Warren-Boulton**

Introduction and Summary

1. My name is John E. Kwoka, jr. I am the Neil F. Finnegan Distinguished Professor of Economics at Northeastern University. I received an A.B. from Brown University in 1967 and a PhD in Economics from the University of Pennsylvania in 1972. I have taught at George Washington University and at the University of North Carolina at Chapel Hill, been a visiting faculty member at Harvard University and Northwestern University, and served in various capacities at the Federal Trade Commission, the Antitrust Division of the Department of Justice, and the Federal Communications Commission. I have also previously served as President of the Industrial Organization Society, Editor of the *Review of Industrial Organization*, Vice-President of the Southern Economic Association, and member of the Editorial Boards of several academic journals. I am presently a Research Fellow of the American Antitrust Institute, a member of the Board of Directors of the Industrial Organization Society, and a member of the Editorial Board of the *Review of Industrial Organization*. I have written, consulted, and testified on various issues in industrial organization, regulation and antitrust policy. My full curriculum vitae is attached at Exhibit A.

2. My name is Frederick R. Warren-Boulton. I am an economist and Principal with MiCRA, an economics consulting and research firm with offices at 1155 Connecticut Avenue, N.W., Washington, D.C. I received a B.A. degree from Yale University, a M.P.A. from the Woodrow Wilson School of Princeton University, and a Ph.D. in Economics from Princeton University. From 1972 to 1983, I was an Assistant and then Associate Professor of Economics at Washington University in St. Louis. From 1983 to 1989, I served as the chief economist for the Antitrust Division of the U.S. Department of Justice, first as Director of its Economic Policy Office and then as Deputy Assistant Attorney General for Economic Analysis. Since leaving the government, I have served as a Resident Scholar at the American Enterprise Institute, a Visiting Lecturer of Public and International Affairs at the Woodrow Wilson School at Princeton University, and as a Research Associate Professor of Psychology at the American University. I have served as an expert witness or consultant on a number of antitrust matters, including as an expert witness for the Department of Justice in *United States v AT&T*, for the Federal Trade Commission in *FTC v Staples and Office Depot*, and for the States and the Department of Justice in *United States v Microsoft*. My full curriculum vitae is attached as Exhibit B.

3. Counsel for Entergy have asked us to provide expert economic testimony regarding the competitive effects of the “paper barriers” governing the operation of the Missouri and Northern Arkansas Railroad Company (“M&NA”), a shortline railroad that presently serves Entergy’s Independence Station electricity generating plant in Newark, Arkansas. The “paper barriers” at issue strongly discourage the M&NA from interchanging traffic with any carrier other than the Union Pacific Railroad Company (“UP”), from which the M&NA acquired its trackage. We have been specifically asked to analyze the proper economics-based policy limitations that should apply to the paper barriers, and the remedy that should be employed in the

event that the Surface Transportation Board (“STB” or “Board”) determines that it would be unreasonable to permit the continued enforcement of the paper barriers affecting the M&NA.

4. The purpose of paper barriers is to protect the income stream of the trunk line railroad when it sells or leases a line to a tenant shortline railroad. Our analysis shows that paper barriers imposed on shortlines preserve or even increase the allocative inefficiency (that is, the degree to which prices diverge from incremental cost) associated with the trunk line’s operation, even as the sale or lease itself encourages cost savings. The challenge for policy is to preserve this mechanism for cost savings while avoiding further harms to allocative efficiency, to socially desirable reorganizations of rail service, to shortlines, and to shippers. Appropriate balancing of these interests would appear to be the objective that the STB set forth in Ex Parte No. 575, *Review of Rail Access and Competition Issues - Renewed Petition of the Western Coal Traffic League* (STB served October 30, 2007) (“Ex Parte No. 575”). There the Board noted that, “to assess the public interest, we must weigh the benefits of a particular interchange commitment against its potential for harm” (p. 8).

5. We also note that the standard under which paper barriers would be evaluated in antitrust would neither treat them as always procompetitive nor condemn them as per se illegal. Indeed, the Department of Justice, in a September 27, 2004 letter from Assistant Attorney General William E. Moschella responding to an inquiry from the House Judiciary Committee, explained that “[i]f paper barriers were subject to the antitrust laws, they would be evaluated under section 1 of the Sherman Act. The Department would examine whether the restraint is ancillary to the sale of the trackage – i.e., whether the restraint is reasonably necessary to achieve the pro-competitive benefits of the sale ” September 27, 2004 Letter from William E. Moschella, Assistant Attorney General, United States Department of Justice, to The Honorable F. James

Sensenbrenner, Jr., Chairman, Committee on the Judiciary, U.S. House of Representatives (*see* Counsel's Exh. No. 18), at 2

6. In this Statement, we discuss the M&NA paper barriers, analyze paper barriers generally, and propose a method for dealing with paper barriers that have been found to be unreasonable that has both substantive and procedural advantages over other policy options. Our proposal—Shipper Right of Approval—is an administratively simple approach that would avoid economically inefficient barriers while permitting those that create benefits to all parties. The facts of the Entergy case illustrate how this method would realize such benefits.

M&NA Paper Barriers and Their Operation

7. We begin with a brief review of the M&NA and the paper barriers that govern its existence and service to Entergy. M&NA was created in 1992, when it acquired trackage from UP by both purchase and lease. UP presumably entered into this arrangement in the belief that it was cheaper to pay M&NA some fraction of the total revenues on the line (the so-called “division”) than to operate the line itself. The lease contains several provisions--the paper barriers--that effectively prevent M&NA from interchanging traffic with carriers other than UP, especially with the BNSF Railway Company (“BNSF”), with which the M&NA interconnects. BNSF serves the origin mines in the Powder River Basin from which Entergy buys coal to burn at Independence Station. BNSF and M&NA thus jointly pose a viable alternate to UP-direct service by which Entergy could receive coal at Independence Station, but the paper barriers prevent use of this alternative.

8. Three provisions of the Lease are particularly relevant. Section 4.01 imposes rent of \$90 million a year (subject to inflation) on the M&NA, but this rent is reduced to the extent that

M&NA interchanges traffic only with UP. The M&NA owes no rent so long as it interchanges at least 95% of its traffic with UP. Section 3.01 of the Lease allows UP to take over servicing the Independence Plant directly by trackage rights upon seven days' notice in exchange for a payment of \$60,000 per year. This provision gives UP additional leverage against M&NA in any renegotiation of the division of revenues between UP and M&NA from Entergy service on the line. Finally, Section 15.01 provides that the paper barrier restrictions continue throughout the duration of the lease. With an initial term of 20 years plus as many as three extensions, the Lease could run for a possible total of 80 years. This section (15.01(f)) also allows UP to terminate the lease if a court or other body determines that the rental provisions are unlawful or improper.

9. Our understanding is that the M&NA paper barriers have been effective. M&NA has exchanged only limited traffic with any carrier other than UP.¹ M&NA has never paid any rent to UP under the lease, and UP has never sought to exercise its trackage rights under the lease. We further understand that M&NA has never interchanged Entergy traffic with BNSF, despite the fact that there have been several periods of time in which UP was unable to meet Entergy's coal needs at Independence and BNSF was prepared to provide such transportation in conjunction with M&NA.

Economics of Paper Barriers

10. It will be helpful to analyze paper barriers using an economic framework that highlights the relevant elements. We do so as follows: Suppose that an incumbent trunk line railroad owns and operates a line from point X to point Z that serves a captive shipper at

¹ We understand that UP has waived the 95% traffic requirement at times to accommodate non-Entergy traffic, including origins and/or commodities that UP could not effectively serve itself.

destination Z. The captive shipper, while disadvantaged by the absence of competition, must purchase services from the trunk line since it has no feasible alternative for obtaining the needed product. Along one portion of the line, there is a second trunk line railroad. That portion is the higher density segment from the origin X to some intermediate point Y. Further, the original trunk line wishes to sell or lease the lower-density segment of the line (YZ) to a shortline. In what follows, we focus on lease rather than sale since it is simpler and conforms more closely to UP/M&NA arrangement.

11. Figure 1 depicts the initial circumstance and the change that results from leasing the segment to a shortline. Operating the segment itself, the incumbent trunk line railroad sets price P_0 on quantity Q_0 of services, and earns profit given by area P_0ABC_0 . C_0 denotes its own unit cost. The gap between price and unit cost is a measure of market power, that is, the degree of misalignment of market price and underlying cost, known in economics as allocative inefficiency. The trunk line will enter into a lease on segment YZ if and only if it benefits by an amount at least as great as it earns from continued ownership and operation. Those benefits will be greater to the extent that the shortline's unit costs are lower than its own, and the trunk line can structure the arrangements to benefit from the shortline's lower costs. The shortline's costs would be lower, for example, if the shortline has lower input costs, equipment better suited to low-density traffic, closer proximity to customers, better managerial focus, etc. The resulting cost reduction—shown in Figure 1 as C_1 —represents a gain in production efficiency in the amount C_0BDC_1 . That production efficiency represents a socially desirable outcome.

12. The key issue concerns what happens to price when unit cost falls. Under certain market conditions, some fraction of the cost reduction may be passed through to the final customer. In other circumstances, however, no pass-through occurs and the entire gain in

production efficiency accrues to the trunk line railroad. This latter scenario can occur for any of several reasons. Rail regulation, for example, may constrain the initial price P_0 to be less than the profit-maximizing price. In Figure 1, the profit-maximizing price might be that shown as P^* , above the regulatory maximum price P_0 . In such a case a cost reduction (at least up to some point) will not be passed-through at all, but instead will simply be pocketed by the incumbent railroad. Another set of circumstances resulting in no price effect would arise if the shipper had access to an alternative supplier that set an effective upper bound on price that the incumbent railroad could charge, an upper bound less than P^* . Much as shown in the previous example, the incumbent railroad, constrained by that price from maximum profitability, would not pass any cost savings through but again simply boost its profits by the amount C_0BDC_1 .

13. We view the no-pass-through case as likely in the current railroad and regulatory setting. The reason is that pricing is constrained by the stand-alone cost test and jurisdictional pricing to something less than full monopoly price to a captive shipper. The analysis therefore implies that the trunk line can and will set lease terms that ensure that it obtains all of the new and greater profit from shortline operation of the YZ segment. Those terms can take the form of an annual fee, a per-unit fee, or some combination of the two.² Regardless, the outcome involves full control of the benefits by the trunk line, none to the shortline (beyond the minimum needed to induce entry into the lease), and none to the shipper. Despite this imbalance of benefits, the outcome meshes the trunk line's private interest in greater profitability with the social interest in efficient production: It is socially desirable to have the shortline take over operation of the YZ

² The incumbent might also obtain indirect benefits from divesting operation to a shortline. Sale or lease frees up scarce management and capital resources to concentrate on the higher-volume and higher-profit parts of its traffic network. "Unit cost" should therefore be interpreted to include the opportunity cost of devoting resources to service on the YZ segment.

segment, since it can produce at lower cost. And it is profitable for the trunk line to let that happen since it can set lease terms that capture all or most of the benefits for itself.

14. At this point, however, the parties' interests diverge. The shortline (and the shipper) would like to interchange with the second trunk line on the XY segment and thereby avoid the remaining monopoly control exercised by the trunk line. This would allow the shortline to create an alternative to the trunk line's monopoly in serving the captive shipper, where the trunk line retains the right to serve the shipper over the XY segment or can require the shortline to provide service to the shipper over XY in conjunction with the trunk line on terms favorable to the trunk line. Since this would drive down price and lower profitability, the trunk line has no interest in allowing the second trunk carrier to serve the XY segment. As a result it will lease out segment YZ to the shortline only on terms that prevent the shortline lessee from interchanging with anyone other than itself.

15. Those terms are, of course, the essence of paper barriers. They make it prohibitively expensive for the shortline to interchange with the alternative trunk railroad and provide competitive through service on XZ to the shipper. As a result, the shortline must interchange with the trunk line on terms that result in no gain to either the shortline (beyond the minimum needed to induce it to assume the risks of the operation) or the shipper. The existence of the potential rival to direct service by the incumbent trunk line, despite its efficiency benefits, is without effect in the market.

16. If the central business fact is that trunk line has the motivation and the ability to oppose use of its YZ segment in this manner, the central policy issue is how to preserve the socially beneficial use of production facilities without harming competitive opportunities and allocative efficiency. We next consider methods of pursuing this objective.

Alternative Treatments of Paper Barriers

17. Entergy has requested that we develop a proposal for relief should the Board determine that paper barrier restrictions in the UP/M&NA Lease are unreasonable. The following discussion assumes that a Board decision precluding the continued enforcement of the UP/M&NA paper barriers leaves unaffected UP's right to terminate the lease arrangement. Our proposal further assumes that UP, after such a lease termination based upon the Board's rejection of the rental provision under Section 4.01 (and UP's direct service rights under Section 3.01), seeks to enter into a new lease of the line.

18. Regulatory approaches to paper barriers could in principle take any of several forms. The Board could continue to permit paper barriers on new and existing spinoffs, with the proviso that shippers could contest rates on the basis of stand-alone costs. Another approach would be to promulgate rules on term length and other conditions in an effort to balance costs and benefits. These methods involve substantial regulatory and other administrative costs, uncertainty about outcomes, and the obvious risks of potential errors. Such limitations of conventional methods prompt interest in identifying a superior alternative in terms of both substance and procedure.

18. That superior alternative for achieving the efficient use of the resource consisting of the YZ rail segment derives from underlying economic principles. The Coase Theorem³ in economics teaches that, absent transaction costs, the efficient allocation will occur regardless of which party to a transaction initially holds the property rights to an asset. The reason is that the asset will inevitably end up in its highest valued use either because (a) it by chance begins there or more likely (b) the party to whom the asset is most valuable will be willing to pay more to

³ The Coase Theorem was presented in the seminal work. Coase, Ronald H., *The Problem of Social Cost*, Journal of Law and Economics 3:1-44 (1960). In 1991, Coase received the Nobel Prize in Economics for this work as well as earlier work on the nature of the firm.

acquire it than the asset is worth to someone else who happens initially to have it. Coase noted that transactions costs can alter this conclusion since such costs create frictions that impede asset reallocation.

19. In the present context the Coase Theorem would imply that, absent transactions costs, the YZ segment will end up in its highest value use whether rights to it are initially held by the trunk line railroad or the shortline or for that matter the shipper or a non-rail entity. Each will have an incentive to reach the same outcome. But transactions costs are significant when railroads contract for sale of track or lease track segments. Contracts are costly to negotiate, write, administer, and enforce, and these costs are nontrivial. As a result, the ordinary process of bargaining cannot be relied upon to produce the optimum allocation of resources. Rather, since resources are likely to be “stuck” where they are initially allocated, some modification of the initial allocation of property rights can overcome the transaction costs and help improve the final allocation.

20. If the property right is to be modified, it could simply be granted to the party that values the asset the most or, if there are two (or more) parties similarly situated, to the one facing the higher transaction costs in acquiring the right. Assignment to the party that values it the most directly ensures optimum allocation, of course, but the choice of optimum allocation is not always so clear. Assignment to the party (among those with similar likely efficiency properties) facing the highest transactions cost of securing the asset will help “steer” the asset in the direction of its higher value use at minimum transactions cost.

21. In the present case the parties to the transaction include the UP, the shortline M&NA, and the captive shipper Entergy. Of these, it is likely to be the shipper that has the highest transaction cost of securing the asset for its best use. After all, the UP engages in such

transactions repeatedly, whereas the shipper does so once or at most a very few times. This asymmetry likely implies a transactions cost handicap to Entergy. In addition, the UP's apparent higher valuation represents in part its monopoly rent on the XZ route. To that extent, its willingness to pay more than other parties does not reflect its higher social value but the existing allocative inefficiency in the market.

22. There is therefore good economic reason either to allocate the property right for the XY segment to the captive shipper rather than to the incumbent, market-dominant railroad, or alternatively, as we propose, to allocate to the captive shipper a corollary right in the prospective use of the XY segment. Such a corollary right might work as follows: Suppose that a shortline leases segment YZ from trunk railroad. The latter can structure the lease so that the captive shipper is no better off than without the shortline. Our proposal is simply to grant the captive shipper the right to approve such an arrangement, without which approval the transaction cannot occur in the form proposed by the trunk line and the shortline.

23. This Shipper Right of Approval (SRA) does not permit the shipper to require the trunk line to enter into a sale or lease, and thus this does not simply reallocate the right to the asset from one party to another. Rather, it requires joint approval and hence mutual benefit from use of the asset. Clearly, the shipper will withhold its approval from those transactions that do it no good, as when the transaction is simply a mechanism by which the trunk line increases its profit by allowing the lower-cost shortline to operate the segment YZ. The shipper will also be unlikely to approve transactions that have prohibitive penalties from interchanging, that run for excessive periods of time, or that are unreasonable in scope.⁴ Assignment and exercise of the

⁴ We note Vice-Chairman Mulvey's repeated objections to paper barriers, especially to those that run in perpetuity: "What is particularly troublesome to me is that these [paper barrier] restrictions on the short lines' ability to interchange with other carriers, and thereby offer shippers a competitive option, go on in perpetuity. Just as new entrants have been the source of

SRA will help ensure the socially optimum allocation of the asset. Of course, the SRA could take different forms depending on the circumstances. For example, it might be efficient in some cases for the shipper(s) to participate in the development of the arrangements, but in others it might be sufficient to allow shippers to comment after an agreement between the trunk line and the shortline has been filed with the STB. The basic principle is that the relevant shipper(s) would need to have an opportunity to approve the proposed arrangement.

24. This benefit of SRA can be illustrated by reference to Figure 2. Figure 2 reproduces the initial cost C_0 , the reduced level of cost C_1 , and the initial regulated price P_0 . As before, the cost reduction results in a production efficiency on quantity Q_0 in the amount C_0BDC_1 , but competition between the incumbent and the shortline-plus-other-trunk line will lower the price to some level such as P_1 . To the extent that demand is at all elastic, that will, in turn, increase quantity sold to Q_1 , reduce the gap between price and unit cost, and increase allocative efficiency by the amount indicated as area AEGD. Thus, without jeopardizing the production efficiency, SRA has increased the social benefit derived from this market.

25. One important advantage of SRA, relative to alternatives, is its administrative simplicity. It does not require regulatory scrutiny of filings by self-interested parties, especially those with asymmetric access to information. It does not require regulatory intervention into private decision-making. It does not involve outsiders' judgments about the appropriate length or scope of the restriction. It does not require agency prescription of the level of compensation. It would avoid endless debate about which barriers may be reasonable and which are not. The parties with the best knowledge and greatest interest in the outcomes resolve the matter

competition for legacy carriers in the airline industry, so too could these new carriers become the source of competition in the rail industry in the future." Written Testimony of Vice Chairman Mulvey (dated September 20, 2007), to the House Committee on Transportation and Infrastructure dated September 20, 2007 (Counsel's Exh No. 10), at 6. We concur.

themselves, with the SRA ensuring movement of the asset toward (if not necessarily all the way to) the optimum allocation. In effect, the SRA would permit and facilitate a market-efficient outcome.⁵

26. While the SRA principle is sound, it is appropriate to note that on some track segments there may be more than a single captive shipper. In such cases there must be a method for aggregating the interests of the multiple shippers into a single vote to approve or disapprove any newly proposed leases. However, this consideration does not appear to amount to a major complication in the case of the M&NA. We understand that Entergy alone accounts for {REDACTED} [REDACTED]. Alternatively, we understand that another shipper and Entergy collectively account for {REDACTED} of the M&NA's traffic. Their combined vote should thus be sufficient for the sound exercise of the SRA.

Application to the M&NA Paper Barriers

27. Against this background, it is our belief that the paper barriers in the M&NA Lease are excessive. There are four reasons for this conclusion. First, there is every indication that Entergy has been in the no-pass-through circumstance, so that the cost savings from shortline operation result in no benefit to the captive shipper but simply accrue to UP. As we explain, this outcome implies a failure to utilize the rail segment asset to any social or even private advantage other than that of the incumbent rail monopoly. Second and related to the above, it appears that the rent provision in the Lease compensates UP based on its lost revenues, not merely on the

⁵ That said, we do not mean to preclude consideration of all other approaches, especially in any particular instance. Instead, our objective is to present a new approach and to note its advantages.

value of its future stream of profits or contribution (revenues less costs).⁶ This standard seems likely to leave UP better off if M&NA actually pays rent than if M&NA performs by interchanging 95% of its traffic with UP.⁷ Further corroborating this, we understand that UP conducted an analysis before entering into the M&NA transaction (*see* Counsel's Exh. No. 7) that demonstrated that the transaction would make a positive contribution to its going concern value, that is, make it "more than whole" by the standard that the STB articulated for reviewing paper barriers in Ex Parte No. 575.⁸ Third, and also related, UP's option under Section 3.01 of the Lease to take back the right to exclusive service to Entergy on seven days notice, for only \$60,000 per remaining contract year, further negates any potential for M&NA to serve as a competitive option.⁹ As previously noted, that provision provides UP with additional leverage

⁶ { [REDACTED] }

⁷ Indeed, the rental provision would appear to fix a price even in excess of the efficient component pricing rule (ECPR), which suggests price based on the incremental profit, not the larger incremental revenue.

⁸ As the STB stated in Ex Parte No. 575 at 10-11 (footnote omitted):

But a carrier considering a line sale or lease of line with traffic that makes a revenue contribution presumably calculates the net present value of the stream of revenue contribution from the traffic it would be forgoing and either (a) demands an equivalent value in the sale price or rental fee, or (b) includes interchange limiting provisions in the sale or lease. The revenue stream resulting from the agreement should be no more than what the carrier would have received had it not divested or leased the rail facilities in question, or had it demanded more in the sale price or rental fee. So long as that is the case, the interchange limiting provision would not overcompensate the carrier and may shift the risk of unexpected traffic loss to the selling or leasing (Class I) carrier -- the party that was more able to assume the risk.

⁹ However, the portion of that provision granting Entergy the option of having UP resume direct service to Independence is pro-competitive and should be retained to avoid creating the "successive monopoly" problem that would arise if M&NA or some successor shortline had the right to serve Independence exclusively.

over M&NA, {
}.

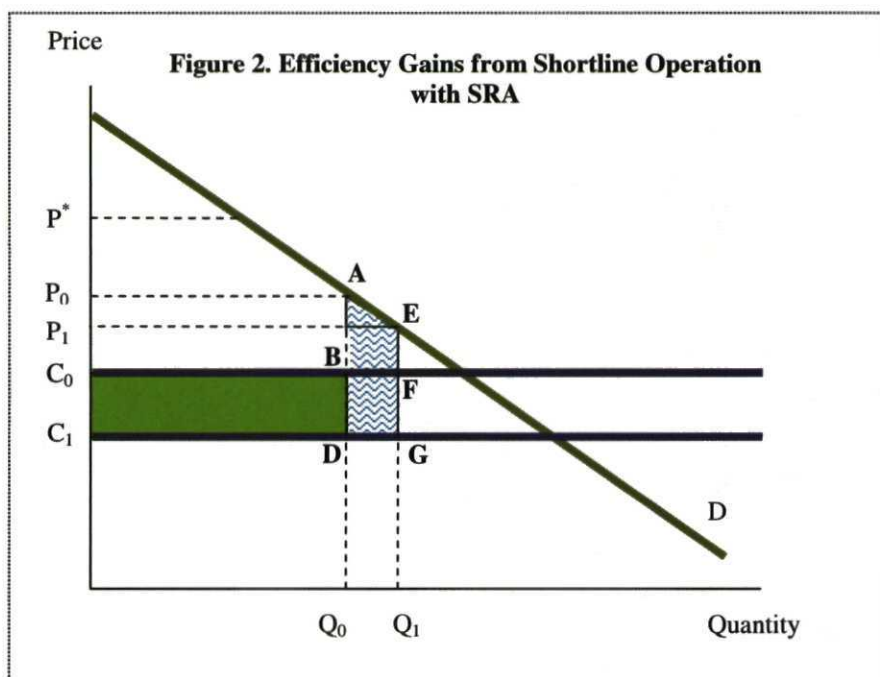
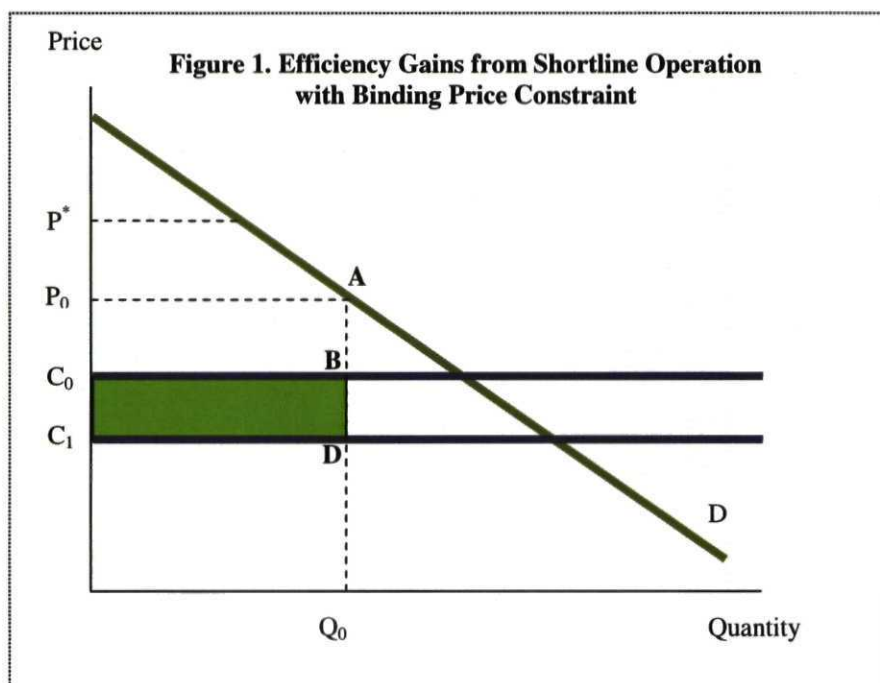
28. A fourth troublesome feature of the UP/MNA Lease is that the paper barriers run for the duration of the Lease, which has an initial term of 20 years plus the potential for three additional such intervals. While it is difficult to determine the precise appropriate length, eighty years is very nearly perpetuity in this and most businesses, and indeed even 20 years is a quite a long time. If the purpose of the lease term is to ensure adequate compensation for the UP, such a lengthy period seems excessive in comparison to other “pay-back” horizons established as policy, e.g., the 20-year life of a patent.

Conclusion

29. Paper barriers represent impediments to competition, to efficient organization of production, and to interests other than incumbent monopoly railroads. These adverse effects are clear in the case of Entergy’s electricity generating plant, which has been denied opportunities to access alternative service since 1992. From a practical standpoint, the question is once a paper barrier has been determined to be unreasonable, what type of remedy should be afforded beyond denying enforcement of the paper barrier. We have proposed a Shipper Right of Approval as a potential remedy that would (a) advance societal welfare, (b) protect the legitimate interests of the incumbent shortline and trunk line, (c) rely on market forces to the extent possible, and (d) relieve the Board (and the parties) of the administrative burden of analysis and decision on the reasonableness of paper barriers.

30. We believe that the paper barriers in the case of UP/MN&A illustrate these various adverse effects, as well as the potential for improvement by use of the SRA approach. We urge consideration of SRA as a remedy in the event that the Board finds that the paper barriers

presently constraining MN&A are unreasonable and UP then seeks to establish new lease terms that include interchange restrictions.



VERIFICATION

I, John E. Kwoka, jr., declare under penalty of perjury that the foregoing Statement is true and correct. Further, I certify that I am qualified and authorized to file this statement

Executed on July 9, 2008

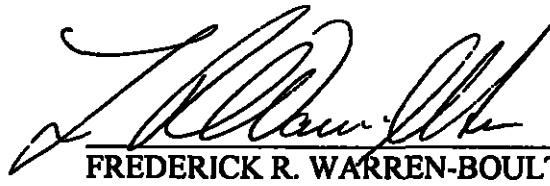


JOHN E. KWOKA, JR.

VERIFICATION

I, Frederick R. Warren-Boulton, declare under penalty of perjury that the foregoing Statement is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on July 8, 2008



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Current Positions:

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Research Fellow, American Antitrust Institute, since 2000

Previous Positions:

Professor of Economics, George Washington University, 1981-2001
Columbian Professor, 2001
Research Professor, 2001-2003
Co-Director, GWU Research Program on Industry Economics and Policy, 1996-2001
Faculty Associate in Public Policy, George Washington University, 1983-2001
General Editor, Review of Industrial Organization, 2001-04
Vice President, Southern Economic Association, 2000-02
Senior Research Scholar, American Antitrust Institute, 2000
Fellow, Center for Business and Government, Kennedy School, Harvard, Summer 2000
Associate Editor, Journal of Industrial Economics, 1990-95, 1998-2001
Editorial Board, Review of Industrial Organization, 1983-2001
President, Industrial Organization Society, 1998-99
Guest Scholar, Brookings Institution, 1995
Visiting Professor of Economics, Harvard University, 1994-95
Special Assistant to the Chief, Common Carrier Bureau, Federal Communications Commission, 1987-88
Board of Editors, Journal of Media Economics: 1987-96
Advisory Board, Antitrust Law and Economics Review: 1985-90
Economist, Economic Policy Office, Department of Justice Antitrust Division, 1985
Visiting Associate Professor of Economics, Northwestern University, 1980-81
Economist, Bureau of Economics, Federal Trade Commission, 1975-81
Economic Policy Fellow, Brookings Institution, 1975-76
Assistant Professor of Economics, University of North Carolina at Chapel Hill, 1972-75
Instructor, Lecturer in Economics, University of Pennsylvania, 1970-72

Education:

Ph.D. in Economics, University of Pennsylvania, 1972
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Rensselaer Polytechnic Institute, 1963 (transferred)

Books:

The Antitrust Revolution, co-edited with Lawrence J. White:

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"The Effects of Market Shares and Share Distribution on Industry Performance," FTC Bureau of Economics Working Paper No. 2, March 1977.

Other:

Principle organizer, Chair of Local Organizing Committee and Finance Committee, International Industrial Organization Conferences, Northeastern University, 2003, 2006.

Award for Meritorious Service, Federal Trade Commission, 1980

"Antitrust Analysis and the 'Cooperative Core': It's the First Two Market Shares That Count," interview by Charles Mueller, Antitrust Law and Economic Review, 1983 (No. 4) and 1984 (No. 1).

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- 1969 M.A., Economics, Princeton University
- 1969 M.P.A., (Master of Public Affairs) Woodrow Wilson School of Public & International Affairs, Princeton University
- 1967 B.A., Economics, Yale University, *cum laude* with High Honors in Economics

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Research Associate Professor of Psychology, The American University, Washington,
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**Assistant in Instruction, Woodrow Wilson School of Public and International Affairs,
Princeton University, Princeton, N.J.; 1969 - 1971.**

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Fields Taught

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Grants

**National Science Foundation. Grant title: "Income Maximizing in Choice and Rate
Effects," 1988 - 1991.**

**National Science Foundation. Grant title: "Application of Economic Theory to Operant
Schedule Effects," 1985 - 1987.**

National Science Foundation. Grant title: "Income and Choice," 1983 - 1985.

Professional Activities

**Referee, *American Economic Review*, *The Bell Journal of Economics/Rand Journal*,
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Economics, Journal of Law and Economics, Journal of Political Economy, Quarterly Journal of Economics, Southern Economic Journal

Member, Editorial Boards, *International Journal of the Economics of Business, Journal of Forensic Economics*

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Languages

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Publications

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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

ENTERGY ARKANSAS, INC. and ENTERGY SERVICES, INC., Complainants	)	
	)	
v.	)	Docket No. 42104
	)	
UNION PACIFIC RAILROAD COMPANY and MISSOURI & NORTHERN ARKANSAS RAILROAD COMPANY, INC., Defendants.	)	
	)	

MISSOURI & NORTHERN ARKANSAS R.R. – LEASE, ACQUISITION AND OPERATION EXEMPTION – MISSOURI PACIFIC R.R. and BURLINGTON N.R.R.	)	
	)	
	)	Finance Docket No. 32187
	)	

ARGUMENT OF COUNSEL

I. SUMMARY

The Board considered the question of the reasonableness of paper barrier restrictions in a general manner in the proceedings leading to its decision in *Review of Rail Access and Competition Issues – Renewed Petition of the Western Coal Traffic League*, STB Ex Parte No. 575 (STB served Oct. 30, 2007) (“Ex Parte No. 575”), but the instant case presents the first opportunity for the Board to apply the general Ex Parte No. 575 principles to the facts of a specific dispute. The application of those general principles to the facts of the instant record warrants a finding in Entergy’s favor.

Consistent with the Board's preliminary observations in Ex Parte No. 575 (STB served Oct. 30, 2007), at 2-5, Entergy does not question that interchange restrictions in agreements relating to the lease or sale of a rail line can play an important role in the development of short-line carriers, and can play an important role in allowing Class I carriers to rationalize their systems and to improve overall service to their customers. Entergy respectfully submits, however, that it is possible for Class I rail carriers to overstep the bounds of reasonableness by imposing restrictions on short-lines that are designed to do more than simply preserve the pre-transaction economic value associated with the divested line. The Board's Ex Parte No. 575 decision similarly recognizes that it is possible, on balance, for an interchange restriction to be unreasonable and inconsistent with the public interest. *Id.* at 7-8 ("A particular interchange commitment may be contrary to the public interest because it is unduly restrictive or unwarranted under the circumstances. Therefore, to assess the public interest, we must weigh the benefits of a particular interchange commitment against its potential for harm."); *id.* at 13 ("The foregoing should not be understood as a suggestion that all current and future interchange commitments are necessarily reasonable and in the public interest").

In its Ex Parte No. 575 decision, the Board drew a line regarding the scope of a legitimate paper barrier restriction. *See* Ex Parte No. 575, October 30, 2007 Decision at 10 ("The revenue stream resulting from the agreement should be no more

than what the carrier would have received had it not divested or leased the rail facilities in question, or had it demanded more in the sale price or rental fee.”) (emphasis added).

Entergy respectfully submits that this aspect of the Board’s decision establishes an appropriate policy standard for determining whether a given paper barrier/interchange restriction constitutes a reasonable practice. In other words, a Class I carrier considering a spin-off transaction may utilize interchange restrictions to the extent necessary to protect the pre-transaction going concern value of its line, but may not rely upon a paper barrier as a means of protecting (or generating) additional profit levels. There is, of course, no reason why a divesting carrier should be precluded from earning more than the line’s pre-transaction going concern value, but as a matter of proper regulatory and economic policy, additional profits derived through a short-line spin-off transaction must be earned in a manner that is independent of the effect of the paper barrier restriction. These additional profits should be derived through production efficiencies or other factors, not through the imposition of anti-competitive contractual penalties.

When considering the enforceability of a contractual liquidated damages provision, courts traditionally consider whether the contracting parties set their stipulated payment at a level that is designed to compensate the non-breaching party for the economic consequences of a breach, or instead, whether the parties set the payment at an unreasonably high level in order to coerce compliance with the contract and/or to punish breach. In much the same way, the standard implicit in the Ex Parte No. 575 decision

would allow a Class I carrier to preserve the pre-transaction value associated with its line. Conversely, this standard indicates that an unreasonable interchange commitment is one that operates as a penalty if it overcompensates the carrier for the pre-transaction value of the line, especially in the very substantial manner demonstrated in this filing.

The continued enforcement of the paper barrier restrictions in the UP/M&NA Lease constitutes an unreasonable practice because UP's rental provision is designed to do far more than simply preserve the going concern value of the line to UP. Instead, this rental provision was designed to act as a penalty and to protect and/or generate a revenue stream vastly greater than the pre-transaction net revenue stream associated with the line. In fact, under the terms of the UP/M&NA Lease, UP would enjoy an extraordinary windfall if M&NA were to interchange substantial levels of traffic with a carrier other than UP. *See* Verified Statement of Mr. Thomas D. Crowley ("Crowley V.S.") at 12-17.

Entergy's evidence demonstrates that the continued enforcement of the paper barriers set forth in the UP/M&NA Lease constitutes an unreasonable practice and is inconsistent with the public interest. This evidence includes the Verified Statements of Mr. William M. Mohl and Mr. Daniel B. Gray (who describe the significance of this case and address the impact of the paper barrier restrictions on Entergy), the Verified Statement of Mr. Thomas D. Crowley (who analyzes the economic value associated with the line and the economic impact of the M&NA transaction and the associated rental

provision), and the Joint Verified Statement of Dr. John E. Kwoka, jr. and Dr. Frederick R. Warren-Boulton (who address the proper policy limitations that should apply to barrier barriers and the remedy that should apply in the event that the Board determines that the continued enforcement of the UP/M&NA paper barrier restrictions constitutes an unreasonable practice).

II. THE UP/M&NA PAPER BARRIER

The UP/M&NA Lease establishes a relationship through which UP has substantial control over the pricing and interchange of traffic on the trackage sold and leased to M&NA in 1992 (the "Line").¹ The Lease uses different means to accomplish this goal, most notably, its imposition of a \$90+ million annual rental obligation that UP will excuse to the extent that M&NA refrains from interchanging traffic with UP's rival carriers.

In that regard, Section 4.01 of the UP/M&NA Lease establishes an annual rent schedule that varies with the percentage of annual traffic that M&NA interchanges with carriers other than UP:

SECTION 4.01 – In consideration of this Lease, and subject to the terms and provisions set forth herein, Lessee agrees to pay Lessor rent for the Leased Premises in the amount of Ninety Million Dollars (\$90,000,000) per year payable annually in advance on the 1st day of March;

¹ A map depicting the Line is set forth in Counsel's Exhibit No. 2. Counsel's Exhibit Nos. 3, 4, and 5 depict different routings that UP has used to deliver Entergy's coal traffic.

PROVIDED, HOWEVER, that subject to the provisions of Section 4.02 hereof, for each lease year that 95% or more of all traffic originating or terminating on the Leased Premises is interchanged with Union Pacific Railroad Company or Missouri Pacific Railroad Company and any affiliated company, their successors and assigns, Lessor agrees that it will waive or partially waive the rent for that particular year in accordance with the schedule set forth in Section 4.03. . . .

SECTION 4.03 – Upon request of Lessor, on or before the 1st day of February of each year following the commencement of this Lease, Lessee shall submit a report, signed by an officer of Lessee, certifying the amount and type of traffic originating or terminating on the Leased Premises during the prior calendar year, the railroads (if any) with which all or portions of such traffic were interchanged, the volume of traffic interchanged with each such railroad, and the total amount of rent due and payable for the previous calendar year. The rent due from Lessee for the Year shall be determined by reference to the percentage of the total traffic (as described in Section 4.01, subject to the provisions of Section 4.02) that was interchanged with Lessor, subject to the terms of Section 4.04, in accordance with the following schedule:

<u>PERCENTAGE OF THE TOTAL TRAFFIC THAT WAS INTER- CHANGED WITH LESSOR</u>	<u>RENT DUE LESSOR</u>
100 - 95%	\$ - 0 -
94 - 85%	\$10,000,000
84 - 75%	\$20,000,000
74 - 65%	\$20,000,000
64 - 55%	\$30,000,000
54 - 45%	\$40,000,000
44 - 35%	\$50,000,000
34 - 25%	\$60,000,000
24 - 15%	\$70,000,000
14 - 5%	\$80,000,000
0 - 4%	\$90,000,000

These rental amounts are subject to escalation each year in accordance with the “Producer Price Index – Finished Goods (Reference Base 1982 = 100),” pursuant to Section 4.04 of the Lease. That section adjusts the annual rent obligations based upon the annual change in the PPI Index from December 1992 to the PPI Index figure for December of the then-current year. As of December of 2007 (*i.e.*, the date of the most recent adjustment), the maximum annual rental amount under the Lease stood at \$114 million.²

In the event of a diversion solely of the Entergy traffic, M&NA would incur an annual rental obligation of {REDACTED} at the 2007 level. *See* Crowley V.S. at 13 n.18. In particular, this diversion would amount to {REDACTED} of the traffic on the eastern portion of the Line,³ thus triggering the base rental obligation of {REDACTED}. *Id.* In 2007, the total carloads on the eastern portion of the M&NA line were {REDACTED} of which {REDACTED} were Independence traffic and {REDACTED} were traffic moving to or from other locations). *Id.* As adjusted, that base rental obligation currently would be {REDACTED}

² The December 2007 PPI index level was 170.6. The index level had been 135.2 as of December 1992. ($\$90 \text{ million} \times (170.6/135.2) = \114 million). *See* Crowley V.S. at 5 n.2.

³ Section 4.01 of the UP/M&NA Lease provides that “[t]he 95% [interchange] level must be achieved separately and simultaneously on the Pleasant Hill-Bergman (including connecting branches) and Guion-Diaz Junction segments.”

The UP/M&NA Lease also gives UP the right to provide exclusive service to the Independence plant via trackage rights on seven days' notice. *See* Section 3.01 ("During the term hereof, Lessor shall not have the right to operate trains over the Leased Premises, except that Lessor may obtain trackage rights between Diaz Junction and Independence, AR, after giving seven days' written notice to Lessee to serve, on an exclusive basis, the Arkansas Power and Light Company (AP&L) plant located at Independence, AR, either at AP&L's request or at Lessor's sole discretion.");⁴ *see also* Section 3.04 ("Lessor may acquire the right to operate over the Leased Premises between milepost 259.05 at Diaz Junction and milepost 270.00 near Independence to serve AP&L and, if this right is exercised, Lessee shall no longer have the right to serve AP&L, and AP&L shall become a closed industry served only by Lessor."). In order to exercise its right to provide exclusive trackage rights service to Independence, UP must pay \$60,000 per year. There is a striking disparity between UP's obligation to pay \$60,000 per year to M&NA if UP elects to provide exclusive service to Independence and M&NA's obligation to pay rent of { } per year, as calculated above, if M&NA were to

⁴ Significantly, this provision gives "either" UP or Entergy the right to insist upon exclusive UP service to Independence. Entergy respectfully submits that while UP's ability to enforce this provision constitutes an unreasonable practice, the Board should preserve Entergy's right to elect to receive UP exclusive service. { }
}. *See* Counsel's Exh. No. 6.

interchange the Independence traffic with a carrier other than UP. That rental amount is nearly { } times as high as the trackage rights fee.⁵

Moreover, Section 15.01 of the UP/M&NA Lease allows termination of the Lease itself if a court or other body determines that the rental provisions are unlawful or otherwise improper. *See* Section 15.01(f) (“This Lease may be terminated as follows: . . . (f) By Lessor or Lessee, by giving 30 days’ written notice to the other party, in the event a court or other body determines that all or any of the provisions of Section IV are unlawful or otherwise unenforceable.”). This provision seeks to insulate UP from the risk that the other contract terms designed to prevent any competitive rail service for the Independence Plant would be found to be unlawful, a possibility that the drafters of the Lease obviously, and correctly, recognized as a significant concern when preparing the agreement.

Significantly, the paper barrier restrictions in the UP/M&NA Lease continue in effect for the entire term of the lease (up to 80 years). As such, those provisions are subject to the “higher level of scrutiny” that the Board identified in its October 30, 2007 decision in Ex Parte No. 575. *See* Ex Parte No. 575 at 15 (“Parties should expect a higher level of scrutiny on agreements that contain a total ban on interchange with other carriers or go on in perpetuity.”).

⁵ { }.

III. BACKGROUND AND HISTORY

A. The Subject Line

The Line at issue in this proceeding is located in the states of Missouri, Arkansas, and Kansas, extending approximately 492 miles from Pleasant Hill, Missouri to Newport, Arkansas. *See* Counsel's Exh. No. 2. This Line is sometimes referred to as the "Carthage Subdivision."⁶ Traffic on the Line consists primarily of coal moving to Entergy's Independence Station and to Kansas City Power & Light Company's Montrose Generating Station near Ladue, Missouri. *Crowley V.S.* at 4. This coal traffic accounts for approximately { [REDACTED] } of the annual carloads on the Line. *Id.* In addition, traffic on the Line includes approximately { [REDACTED]

[REDACTED]
[REDACTED] }

Prior to 1989, coal traffic moving to Independence traveled from Kansas City via the length of the Carthage Subdivision. *Gray V.S.* at 3; Counsel's Exh. No. 3.⁷ Following the implementation of UP's merger with the Missouri-Kansas-Texas Railway Company ("MKT"), UP elected to re-route the Independence traffic off the majority of

⁶ *See* Counsel's Exh. No. 7 at 302.

⁷ Initial coal transportation service to Independence was provided by BNSF and MP pursuant to tariff. Specifically, BNSF transported coal from the PRB to Kansas City where it was interchanged to MP. MP then transported the coal via the Carthage Subdivision to the plant. *Gray V.S.* at 3 n.1. In 1983, Entergy entered into a long-term coal transportation contract with UP and MP. *Id.* at 2. As with the previous tariff movement, MP transported the coal via the Carthage Subdivision from Kansas City to the plant. *Id.* The Line includes the entirety of the Carthage Subdivision. *See* Counsel's Exh. No. 7 at 302.

the Carthage Subdivision. *See* Counsel's Exh. No. 4. Under this new routing, UP transported loaded coal trains to Independence via north Little Rock, Arkansas, and then to the Independence Station from the east via Newport, Arkansas. *Id.* UP returned empty coal trains to the Powder River Basin via this same route. *Id.*

In 1998 (several years after the execution of the UP/M&NA Lease), UP made an additional change to the routing of the Independence traffic. *See* Counsel's Exh. No. 5; Gray V.S. at 4. In particular, UP implemented a system under which loaded coal trains would continue to be transported to Independence via Little Rock, but empty trains would be returned to the PRB over the entire length of the Carthage Subdivision. *Id.*

M&NA currently maintains interchanges with UP, BNSF (at Aurora, MO, Springfield, MO, and Lamar, MO), and Kansas City Southern Railway Company (at Joplin, MO). *See* Counsel's Exh. No. 2. In the absence of the paper barrier restrictions in the UP/M&NA Lease, coal transportation service could be provided from the PRB to Independence with BNSF-M&NA via these interchange points. PRB coal transportation service also could be provided to Independence (in the absence of the paper barrier restrictions) via BNSF-M&NA with an interchange between the carriers at Fort Scott, Kansas, which is an interchange point referenced in the UP/M&NA Lease. *See* UP/M&NA Lease at Section 3.01. Although M&NA has removed some connecting track associated with this interchange with BNSF at Fort Scott, Kansas (*see* M&NA Answer at ¶ 22) it is, of course, possible to restore this interchange track.

In its Complaint, Entergy set forth its understanding that upgrading of the M&NA Line would be necessary to facilitate the transportation of loaded coal trains from a point of interchange with BNSF. *See* Complaint at ¶ 21 (“The handling of loaded coal trains over the M&NA line over either of these routes may require some upgrading.”). M&NA’s Answer in this proceeding suggested that “[t]hese routes will require substantial upgrading to handle loaded unit coal trains” and that “[t]he interchanges with BNSF would also require substantial upgrading.” *Id.* at ¶ 21; *see also* UP’s Answer at ¶ 21 (“[T]he handling of loaded coal trains over certain M&NA lines not currently used to handle loaded coal trains may require upgrading the lines.”). In discovery in this case, Entergy requested that M&NA produce “any analyses regarding the nature and/or cost of any work that would be necessary to upgrade M&NA’s lines to permit M&NA to handle loaded Entergy trains.” *See* Entergy’s Request No. 12 (Counsel’s Exh. No. 8). M&NA objected to this request on grounds of relevance, ambiguity, and the need to prepare a special study, and declined to produce responsive documents. *See* M&NA’s Reply to Entergy’s Request No. 12 (Counsel’s Exh. No. 9).

B. Ex Parte No. 575 and the Railroad Industry Agreement

On February 20, 1998, in the midst of the service crisis that followed UP’s merger with SP, the STB instituted a new proceeding to evaluate the subjects of access and competition in the railroad industry. *See Review of Rail Access and Competition Issues*, STB Ex Parte No. 575 (STB served Feb. 20, 1998) at 1. Following a two-day

hearing in this proceeding, the Board decided to allow the large and small railroads to work together to develop negotiated solutions to certain competitive problems in the industry. Specifically, in a decision served April 17, 1998, the Board accepted the invitation of rail carriers to allow them to craft their own resolution to the paper barrier problem. *Review of Rail Access and Competition Issues*, STB Ex Parte No. 575 (STB served Apr. 17, 1998) at 8 (“At the hearing, we were advised that the smaller railroads and the large railroads have initiated discussions to address these concerns. Because we believe that private-sector solutions are generally preferable, we urge the parties to address and resolve these issues themselves . . .”).

The rail industry’s response to this STB directive was to develop the September 10, 1998 Railroad Industry Agreement (“RIA”). The RIA purported to resolve the paper barrier problem, but lacked any real substantive significance or any mechanism through which a shipper could challenge a paper barrier as unreasonable. In particular, the RIA included a principle stating that “[o]nly legitimate ‘paper barriers’ should be enforceable,” but it defined “legitimate” in a broad and largely subjective manner (i.e., legitimate barriers are those that are designed as “fair payment”). As long as an incumbent Class I carrier was willing to provide service to the captive traffic and as long as its paper barrier was designed to provide “fair” payment to the Class I carrier

under a vague standard of fairness (to be interpreted by the railroads themselves), the enforcement of a given paper barrier would not violate the RIA.⁸

On December 21, 1998, the Western Coal Traffic League (“WCTL”) filed a “Petition for Further Rulemaking to Eliminate Unreasonable ‘Paper Barriers’ to Interchange” (“1998 Petition”). WCTL submitted proposed regulations with its Petition that would have created rebuttable presumptions of unreasonableness for any paper barrier that: (1) lasts longer than five years; (2) includes any financial penalty on the purchaser that is triggered by the interchange of traffic with a carrier other than the selling carrier, even when traffic interchanged with the selling carrier is not thereby reduced; or (3) includes credits for traffic interchanged with the selling carrier against a rental or sale price that reflects a return of more than the railroad industry’s cost of capital on the fair market value of the properties sold or leased. *See* 1998 Petition at Appendix B, pp. 1-2.

By decision served March 2, 1999, however, the STB decided that it should defer action on WCTL’s 1998 Petition pending the STB’s review of experience under the RIA. *Review of Rail Access and Competition Issues*, Ex Parte No. 575 (STB served March 2, 1999). In so doing, the Board expressed concern that it should not interfere with the efforts of the large and small rail carriers to solve the paper barriers issue through a negotiated agreement. *Id.* at 3.

⁸ A reasonable definition of “fair” payment would be the amount necessary to allow the Class I carrier to preserve the pre-transaction going concern value of its line.

C. WCTL's Renewed 2005 Petition and the STB's Proceeding

On March 21, 2005, more than six years after the Board decided to hold WCTL's petition in abeyance, WCTL filed a "Renewed Petition for Rulemaking to Eliminate Unreasonable 'Paper Barriers' to Interchange" ("2005 Petition"). Therein, WCTL argued that since the date of the Board's decision to hold the 1998 Petition in abeyance, pre-existing paper barriers had continued to restrain competition for substantial volumes of traffic originating or terminating on small railroads, and Class I carriers had continued to create new paper barriers as they spun off more of their marginal rail lines to small, typically non-union, carriers. *Id.* at 4.

WCTL further explained that amendments to the RIA had failed to address the principal failings in the RIA; namely, the continuing absence of any remedy under the RIA for the effect of paper barriers on pre-existing traffic, and the continuing absence of any remedy whatsoever under the RIA for adversely affected shippers (rather than merely for short lines). *Id.*

On February 1 2006, approximately one year after WCTL filed its 2005 Petition, the STB issued a decision requesting opening and reply comments on the Petition from any interested member of the public. In its decision, the STB explained that it was "especially interested" in receiving comments that:

- (a) discuss our statutory authority to address pre-existing paper barriers;

- (b) identify and describe existing paper barriers so that we can determine the extent of the problem alleged by WCTL;
- (c) identify and quantify any problems experienced by shippers as a result of paper barriers;
- (d) address the short and long term impacts of paper barriers;
- (e) address the effectiveness of the existing AAR/ASLRRRA agreement on paper barriers; and
- (f) include information about the RIA, including the most recent version, amendment history, interpretations, proceedings, handbooks, etc.

Id. at 4. A number of interested parties submitted written comments in response to the Board's invitation.

On June 2, 2006, the STB determined that it would hold a public hearing on July 27, 2006 to allow interested parties to express their views concerning the subject of paper barriers. *See Review of Rail Access and Competition Issues – Renewed Petition of the Western Coal Traffic League*, STB Ex Parte No. 575 (STB served June 2, 2006), at 1. The STB's hearing included four panels with a total of twenty-one witnesses.⁹

⁹ On September 20, 2007, Vice Chairman Mulvey submitted written testimony to the House Committee on Transportation and Infrastructure on the subject of paper barriers. Therein, he stated that "I find this practice to be anti-competitive and I have dissented from the majority in several cases where paper barriers were contained in the sales or lease agreements.[] What is particularly troublesome to me is that these restrictions on the short lines' ability to interchange with other carriers, and thereby offer shippers a competitive option, go on in perpetuity. Just as new entrants have been the source of competition for legacy carriers in the airline industry, so too could these new carriers become the source of competition in the rail industry in the future." *See Written*

D. The Board's October 30, 2007 Decision

On October 30, 2007, the Board served its decision in Ex Parte No. 575 finding that the propriety of interchange commitments "is best considered on an individual, case-by-case basis." *Id.* at 1. The Board's decision reviewed the history and role of interchange commitments in the rail industry, discussed WCTL's request, and set forth the Board's own proposal and provided general guidance regarding the factors that the Board will consider in determining whether a particular interchange commitment is permissible. *Id.* at 1-2.

The Board's review of the history of interchange commitments included a number of statements regarding the benefits supposedly inherent in the transfer of lines to short-line carriers. *See, e.g.*, Ex Parte No. 575 at 3 ("Many short lines can operate their lines at lower costs than could the larger carriers from which they acquired or leased their lines."); *id.* ("Offering better service, the short lines have been able to attract new traffic to their lines."). In addition, the Board observed that many short-line transactions include paper barrier restrictions that ostensibly have been required to permit the subject transactions to take place and that themselves therefore have been responsible for generating public benefits. *Id.* at 4, 7, 14.

After concluding that it would not grant the relief that WCTL sought, the Board instead explained that it would consider the propriety of interchange commitments

Testimony of Vice Chairman Mulvey (dated September 20, 2007) at 6 (Counsel's Exh. No. 10).

on a case-by-case basis. *Id.* at 14. In order to give some guidance to parties seeking to challenge paper barriers, the Board identified factors that it will consider when determining the propriety of an interchange commitment:

When the Board considers whether a proposed interchange commitment is in the public interest, we will examine the relevant facts and circumstances surrounding that agreement. We will consider whether the interchange agreement is part of a lease or a sale of a line, and we will look at the duration of the restriction. We will examine the manner in which the interchange commitment discourages interchange with other carriers and the degree to which interchange is effectively foreclosed. Parties should expect a higher level of scrutiny on agreements that contain a total ban on interchange with other carriers or go on in perpetuity.

Id. at 15 (emphasis added); *see also id.* (“The factors to be considered will also depend upon the type of challenge brought before the Board.”). As explained above, the higher level of scrutiny that the Board describes applies in the instant case because the paper barrier in the UP/M&NA Lease goes on in perpetuity in the sense that it extends for the full term of the lease, which may be eighty years.

The Board also offered some insight in its Ex Parte No. 575 decision into its views regarding the creation of legitimate paper barriers. Specifically, when addressing some of the rebuttable presumptions that WCTL had proposed, the Board provided an explanation of its understanding of the process through which Class I carriers impose paper barriers and the proper bounds within which such paper barriers must be limited:

Some shippers maintain that interchange commitments that last longer than 5 years are likely to over-compensate the seller or lessor carrier. But a carrier considering a line sale or lease of [a] line with traffic that makes a revenue contribution presumably calculates the net present value of the stream of revenue contribution from the traffic it would be foregoing and either (a) demands an equivalent value in the sale price or rental fee, or (b) includes interchange limiting provisions in the sale or lease. The revenue stream resulting from the agreement should be no more than what the carrier would have received had it not divested or leased the rail facilities in question, or had it demanded more in the sale price or rental fee. So long as that is the case, the interchange limiting provision would not overcompensate the carrier and may shift the risk of unexpected traffic loss to the selling or leasing (Class I) carrier – the party that was more able to assume the risk.

Id. at 10-11 (emphasis added).

Finally, the Board confirmed in its Ex Parte No. 575 decision that the existence of the RIA “does not preclude or otherwise affect the ability of shippers to seek relief from the Board.” *Id.*

III. UP’S PRE-TRANSACTION ECONOMIC EVALUATION AND THE BASIS FOR UP’S CALCULATION OF THE ANNUAL RENT

A. UP’s Development and Economic Evaluation of the Lease

{ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] } See Deposition of Mr. Warren C. Wilson (“Wilson Dep. Tr.”)

(Counsel’s Exh. No. 12) at 9; *see also* UP-Counsel’s Exh. No. 7 at 303 { [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] }

{ [REDACTED]

[REDACTED]

[REDACTED] } UP engaged in an economic analysis of the

proposed lease/sale transaction. *See* UP’s “Approval for Line Disposition” analysis set

forth in Counsel’s Exh. No. 7 hereto. UP’s Approval for Line Disposition analysis

presented UP’s estimate of the Going Concern Value (“GCV”) of the Carthage

Subdivision and compared that figure to the estimated After-Tax Net Present Value

(“ATNPV”) of the stream of payments under the proposed lease/sale with RailTex. { [REDACTED]

[illegible]

_____ }

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Q. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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[REDACTED]

[REDACTED]

[REDACTED]

Counsel's Exh. 12 at 35-37 (emphasis added); *see also id.* at 108 ("Q. { [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] } Under analogous

principles of Missouri law, which the railroads chose to govern the lease, the continued enforcement of that rental provision therefore is unreasonable. *See* Section V(A)(3), below.

IV. SUBSEQUENT AMENDMENTS TO THE LEASE

The parties executed the UP/M&NA Lease on December 11, 1992. A complete copy of the lease including its various exhibits is set forth as Counsel's Exhibit No. 1. There have been ten subsequent amendments ("Supplemental Agreements") to the UP/M&NA Lease, { [REDACTED]

[REDACTED]

[REDACTED] }

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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[REDACTED]

V. IMPACT OF THE PAPER BARRIER ON ENTERGY

In their accompanying Verified Statements, Entergy's Mr. William Mohl and Mr. Daniel Gray explain the impact that the UP/M&NA paper barrier has had upon Entergy. That impact has been felt most significantly in a number of instances in which UP's service has not been adequate. In those situations, Entergy has requested that UP permit another carrier to provide service to Independence in conjunction with M&NA, but UP has steadfastly refused to allow such a movement.

Entergy understands that UP has had an interest in preserving the value of its Line, but Entergy submits that UP could have protected this value in a far less onerous manner that would have permitted Entergy to consider whether avoiding burn curtailments at Independence was sufficiently important in a given circumstance in order to justify the payment of rates that included some reasonable measure of compensation to UP for the use of its Line. The unreasonable level of the UP/M&NA paper barrier prevented Entergy from having that option.

As Mr. Gray explains in his Verified Statement, there have been three separate time periods in which Entergy has endeavored to obtain alternative service to Independence because of UP service failures. *See Gray V.S. at 5-11.* Those included 1993-1995, 1997-1998, and 2005-2006. *Id.* UP refused to permit alternative service to Independence in each instance. *Id.*

Mr. Mohl confirms in his Verified Statement that the Independence Station plays a vital role in the reliability of the Entergy system for the people of Arkansas. In the absence of the unreasonable paper barrier restrictions in the UP/M&NA Lease, M&NA could help to ensure that “will have options available to at least mitigate the damage that is caused when UP is unable, or unwilling, to deliver all of the coal needs for Independence.” Mohl V.S. at 5. Mr. Mohl adds that the lease agreement “creates a fictional option where it appears that M&NA is independent and available to provide

supplemental coal, but in reality the lease agreement is so onerous that economic interchange of traffic with a non-UP carrier is cost prohibitive.” *Id.* at 5-6.

Mr. Mohl’s statement also includes an explanation of the recent, pronounced change in UP’s practice of declaring force majeure on its system. Specifically, Mr. Mohl comments upon UP’s increased tendency to hide service failures behind claims of force majeure:

In the first twenty-two years (1983 - April 2005) that UP delivered coal to Independence UP declared force majeure a total of 8 times. Only one of these claims (relating to the 1993 Midwestern floods) exceeded a few days. By contrast, in the last three years of service (April 2005-April 2008) UP has declared force majeure 27 times, including the 2005 force majeure that lasted almost seven months. In total, UP’s claimed force majeure events have consumed 487.1 days in the last three years. Stated another way, during the last three years UP has claimed to be excused from its delivery obligations to our Arkansas coal plants *for approximately 45% of this time period.*

Mohl V.S. at 7. Mr. Mohl adds that UP’s “propensity to claim force majeure further underscores why many shippers, including ESI and EAI, are becoming increasingly concerned about the reliability of the rail network and how it can impact on the reliability of our ability to provide service.” *Id.* at 7-8. Again, the continued enforcement of the paper barrier in the UP/M&NA Lease prevents Entergy from obtaining alternative coal transportation service during times when UP is unable to deliver coal in an adequate manner.

Finally, Mr. Mohl explains in his statement (Mohl V.S. at 8-9) that, as a result of Entergy's concern regarding the prospect of further service problems at Independence, Entergy submitted a Pre-filing Notice to the Board on February 22, 2008 indicating its intent to file a Petition for Exemption from the prior approval requirements of 49 U.S.C. § 10901 and 49 C.F.R. Part 1150 for the construction of a new line of railroad that would connect Independence to BNSF near Hoxie, Arkansas. *In the Matter of Entergy Arkansas, Inc. and Entergy Services, Inc. – Petition for Exemption – Construction and Operation of a Line of Railroad in Independence, Jackson, and Lawrence Counties, Arkansas*, STB Finance Docket No. 35122. Mr. Mohl notes, however, that the construction of this duplicative line to allow Entergy to access alternative service from BNSF “might not be necessary if the Board grants Entergy the requested relief from the paper barriers in the UP/M&NA lease agreement.” *Id.* at 8. Relief in this proceeding would benefit the public that Entergy serves in several key respects:

(1) it would provide a means to bolster the reliability of coal generation at Independence by assuring that there is a means to obtain supplemental coal deliveries when UP is unable, or unwilling, to deliver coal to Independence; (2) use of the existing M&NA lines would be less costly, when contrasted to the costs of constructing an entirely new line; and (3) the disruptive nature of an otherwise unnecessary rail construction project (i.e., in the form of environmental concerns and other interests of the communities through which the construction would traverse) could be avoided.

Id. at 8-9.

Document production in this case suggests that M&NA had been willing to participate in the movement of coal to Independence in conjunction with a carrier other than UP. For example, M&NA's document production includes a handwritten summary of four conversations between Larry Fields (General Manager of M&NA) and Gil Richardson (Manager Coal Marketing of Burlington Northern ("BN")) in May of 1994 in which M&NA provided its revenue requirement { [REDACTED] } for a joint movement with BN via Fort Scott, Kansas or Lamar, Missouri. *See* Counsel's Exh. No. 15 (including separate versions of this document produced in discovery) at 1088; *see also id.* at 1086 (in which Mr. Fields refers to the attached notes of his conversations with BN). Mr. Fields' notes further indicate that M&NA's revenue requirement assumed that BN would supply the locomotive power for the entire trip on M&NA, and that M&NA was willing to perform 1,000-mile inspections on this traffic. *Id.*¹²

Similarly, M&NA's document production also includes a request from M&NA to UP dated October 6, 2006 for a waiver of the rental provision to permit M&NA to provide service to Independence. *See* Counsel's Exh. No. 16 at 1080 ("MNA requests UP to waive the provisions of Section 4 of the Lease, as amended. MNA proposes to exclude the 75,000 tons of coal that Entergy seeks to use for the test burn . . .

¹² Mr. Fields commented in his cover note that he would like to "hold off about a week/10 days on this to try & give Union Pacific time to respond to our (M&NA) request for APL trains via KC Neff Yard" (*see* Counsel's Exh. No. 15 at 1086), but it is nevertheless evident that M&NA's discussions with BN had advanced to the point at which M&NA had indicated a willingness to participate in a joint movement to Independence.

. If UP is agreeable to this waiver, MNA will provide an appropriate supplemental agreement for UP to review. Please notify MNA of UP's decision within two weeks of the date of this letter."}. { [REDACTED] } Seven days after the date of M&NA's letter to UP, however, M&NA advised Entergy that it could not quote a rate to Entergy for the 75,000 ton test burn movement. *See* Counsel's Exh. No. 17 at 1079. M&NA did not address the subject of its communications with UP in its letter to Entergy, instead suggesting that the absence of specific operational information from Entergy prevented M&NA from quoting a rate. *Id.*

UP's refusal to permit M&NA to participate in the movement of coal to Entergy, even at times when UP was unable to provide adequate service and M&NA was willing and able to provide service in conjunction with BN or CN/KCS, demonstrates clear and significant harm that has been associated with the UP/M&NA paper barrier.

VI. ARGUMENT

A. The Continued Enforcement of the UP/M&NA Paper Barrier Restriction Constitutes an Unreasonable Practice

1. Legal Standard

The Board has authority under Title 49 to evaluate railroad practices on reasonableness grounds and to prescribe new railroad practices, if appropriate. *See* 49

U.S.C. § 10702 (“A rail carrier providing transportation or service subject to the jurisdiction of the Board under this part shall establish reasonable – . . . (2) rules and practices on matters related to that transportation or service.”); 49 U.S.C. § 10704(a)(1) (“When the Board, after a full hearing, decides that a rate charged or collected by a rail carrier for transportation subject to the jurisdiction of the Board under this part, or that a classification, rule, or practice of that carrier, does or will violate this part, the Board may prescribe the maximum rate, classification, rule, or practice to be followed. The Board may order the carrier to stop the violation. When a rate, classification, rule, or practice is prescribed under this subsection, the affected carrier may not publish, charge, or collect a different rate and shall adopt the classification and observe the rule or practice prescribed by the Board.”).¹³

The Board has observed that the inquiry into a potential unreasonable practice is – by virtue of the nature of the governing statute – a fact-based inquiry that must be tailored to the specific practice at issue:

The statute does not specifically define what constitutes an unreasonable practice. Rather, in view of the wide variety of situations that might arise, Congress has committed such determinations to the Board. The agency has developed no single test for judging whether a particular practice is unreasonable, leaving that fact-specific inquiry to a case-by-case analysis.

WTL Rail Corp. – Petition for Declaratory Order and Interim Relief, STB Docket No.

¹³ Notably, the agency may exercise its jurisdiction over unreasonable practices in the absence of any market dominance finding. *Union Pacific R.R. v. ICC*, 867 F.2d 646, 649 (D.C. Cir. 1989).

42092 (STB served Feb. 17, 2006), at 6; *see also Capitol Materials Incorporated – Petition for Declaratory Order – Certain Rates and Practices of Norfolk Southern Ry.*, STB Docket No. 42068 (STB served April 12, 2004), at 6 (“Whether a particular practice is unreasonable typically turns on the particular facts.”). Consequently, in light of Congress’ broad deference to the Board in implementing its statutory authority over unreasonable practices, the Board can approach the question of the propriety of paper barriers with great latitude, and may use its authority under §§ 10702 and 10704 to determine whether the continuing enforcement of paper barriers constitutes an unreasonable practice. *See North America Freight Car Ass’n v. STB*, No. 07-1070, 2008 WL 2491983, at *2 (D.C. Cir. June 24, 2008) (explaining that the Board has “wide discretion in formulating appropriate solutions” in the context of an unreasonable practice complaint).

The Board has invoked its authority over unreasonable railroad practices on a number of occasions. *See, e.g., Granite State Concrete Co. v. Boston and Maine Corp.*, STB Docket No. 42083 (STB served Sept. 15, 2003), at 5 (“The Board will commence a proceeding under 49 U.S.C. 11701(c) (sic) into whether BM/ST [by restricting hours of operation in which trackage rights can be used] is failing to fulfill its common carrier service obligation and engaging in unreasonable practices.”); *APL Land Transport Services, Inc. v. The Burlington Northern and Santa Fe Ry.*, STB Docket No. 42003 (STB served July 14, 1999), at 11 (finding that BNSF’s failure to satisfy the tariff

requirement to promptly return APL's empty cars results in an unreasonable practice contrary to 49 U.S.C. 10702(2) and directing BNSF to "cease and desist from violating Item 454-B of the Mileage Tariff."); *see also Liability for Contaminated Covered Hopper Cars*, 10 I.C.C.2d 154 (1994) (finding an unreasonable practice where tariff language required grain shippers to inspect railroad-supplied cars (and imposed liability for consequential damages associated with contamination of products) constituted an unreasonable practice). The Board's approach to the western rail service crisis also supports the view that when endeavoring to resolve a transportation-related problem with widespread scope, the Board's jurisdiction is particularly broad. *See, e.g., Joint Petition for Service Order*, STB Service Order No. 1518 (STB served Oct. 31 and Dec. 4, 1997, and Feb. 17 and 25, 1998).

As noted above, the Board confirmed in Ex Parte No. 575 that the revenue stream resulting from a spin-off agreement that is protected by an interchange restriction "should be no more than what the carrier would have received had it not divested or leased the rail facilities in question, or had it demanded more in the sale price or rental fee." Ex Parte No. 575 at 10; *id.* at 10-11 ("So long as that is the case, the interchange limiting provision would not overcompensate the carrier . . ."). Stated differently, a reasonable interchange commitment practice is one that relies upon paper barrier restrictions to protect only the pre-transaction Going Concern Value of the Line. It

follows that the enforcement of a paper barrier restriction that goes beyond this limitation constitutes an unreasonable practice.

Significantly, in *Rail Fuel Surcharges*, STB Ex Parte No. 661 (STB served Aug. 3, 2006), the Board responded to concerns regarding the nature of railroad fuel surcharges on the basis of its jurisdiction over unreasonable practices, commenting that it was “addressing what we believe is an unreasonable practice of applying what the railroads label a fuel surcharge in a manner that is not limited to recouping increased fuel costs that are not reflected in the base rate.” *Id.* at 4 (emphasis added). The Board further explained in this regard that “[a] carrier should not identify a surcharge as a cost-recovery mechanism for a discrete portion of its costs unless the surcharge is directly tied to and limited to the incremental changes in that particular cost for the movements to which the surcharge is applied. . . . [R]ailroads should not call a charge a fuel surcharge if it is designed to recover more than the incremental cost of fuel attributable to the movement involved.” *Id.* at 4-5 (emphasis added).

In the instant proceeding, Entergy challenges a contractual provision that the UP/M&NA Lease identifies as a rental payment. As Entergy demonstrates in this opening evidence, however, the actual nature of the provision is inconsistent with this label. In fact, the stated rental obligation in the UP/M&NA Lease operates as an improper penalty to discourage M&NA from engaging in the interchange of traffic with another Class I carrier (and to provide for excessive compensation to UP if M&NA

engages in the interchange of traffic beyond a permissible level). The characterization of this penalty as a rental provision constitutes an unreasonable practice in the same manner as the railroads' unreasonable fuel surcharge practices in Ex Parte No. 661.

2. Limiting the Scope of Paper Barriers to the Protection of Pre-Transaction Going Concern Value is Consistent with the Board's Decision in Ex Parte No. 575, DOJ Policy, and Vice Chairman Mulvey's Previously Stated Opposition to Unlimited Paper Barriers

As Entergy explained above, the Board's Ex Parte No. 575 decision supports allowing Class I carriers to utilize paper barriers to protect the pre-transaction Going Concern Value of their lines. Restrictions that go beyond that level (such as the UP/M&NA Lease restriction), preclude the interchange of traffic without justification in situations that would benefit the public interest.

This understanding of the proper limitation on the use of paper barriers is consistent with the approach to paper barriers advocated by the Department of Justice in response to a 2004 inquiry from the House Judiciary Committee. *See* Counsel's Exh. No. 18. Therein, Assistant Attorney General William E. Moschella explained that "[i]f paper barriers were subject to the antitrust laws, they would be evaluated under section 1 of the Sherman Act. The Department would examine whether the restraint is ancillary to the sale of the trackage – i.e., whether the restraint is reasonably necessary to achieve the pro-competitive benefits of the sale." September 27, 2004 Letter from William E. Moschella, Assistant Attorney General, United States Department of Justice, to The

Honorable F. James Sensenbrenner, Jr., Chairman, Committee on the Judiciary, U.S. House of Representatives, at 2.

This limitation also is consistent with the rationale underlying the dissenting statements made by Vice Chairman Mulvey in prior proceedings involving paper barriers. In those dissenting statements, Vice Chairman Mulvey expressed the view that paper barriers are fundamentally anti-competitive. For example, in *Buckingham Branch R R – Lease – CSX Transp., Inc* , STB Finance Docket No. 34495 (STB served Nov. 5, 2004), Vice-Chairman Mulvey explained that paper barriers operate as restraints of trade and are contrary to the public interest:

I dissent from the Board's decision in this case. I find that the lease agreement between Buckingham Branch Railroad and CSXT includes a fundamentally anti-competitive provision – the erection of what is essentially a “paper barrier” – that would operate as a restraint of trade in rail transportation in the region.

Paper barriers are clauses in contracts for the sale or lease of rail lines to shortline carriers by which Class I carrier sellers seek to ensure that the traffic originated or terminated by shortline carriers on the segments (sold or leased) continues to flow over the lines of the seller to the maximum extent possible. As such, these restrictions effectively tie the shortline to a single Class I carrier, thereby restricting the flow of interstate commerce and reducing the potential public benefits of the lease transaction.

In the lease agreement at issue, BBRR must pay to CSXT, in addition to its regular lease payments, additional payments on a per car basis for interchanging current CSXT traffic with other carriers. In effect, this raises the cost to BBRR of entering the market if it chooses to interline with a

carrier other than CSXT. At oral argument, CSXT admitted that this surcharge is based at least in part on competitive concerns, and the BBRR witness admitted that this had been the most contentious issue in the parties' negotiations.

I concede that paper barriers result from voluntary negotiations between private parties. However, that these provisions conflict with the notion of avoiding restraints of trade is beyond doubt. I do not believe that the Board should continue to condone this practice. While I would prefer not to interfere with contracts between private individuals, I believe the Board should do so when contractual provisions run counter to public policy and the public interest as a whole. Thus, while restrictions on interchange may be in the private interests of two railroads, they nevertheless operate as a restraint of trade and run counter to the public interest.

Id. at 13 (Mulvey, dissenting) (emphasis added); *accord Paducah & Louisville Ry., Inc. – Acquisition – CSX Transp., Inc.*, STB Finance Docket No. 347381 (STB served Nov. 18, 2005), at 6-7 (Mulvey, dissenting) (same). A decision to limit the scope of paper barrier restrictions to the preservation or insulation of the pre-transaction Going Concern Value of a line allows the protection of the private interests of the Class I carrier while also protecting the public interest underlying Vice Chairman Mulvey's concerns regarding unreasonable restraints of trade.

3. Limiting the Scope of Paper Barriers to the Protection of Pre-Transaction Going Concern Value is Consistent with Analogous Legal Principles Regarding Liquidated Damages and Covenants Not to Compete

The limitation of paper barrier restrictions to the preservation of pre-transaction Going Concern Value also is consistent with analogous legal principles regarding liquidated damages provisions and covenants not to compete.

a. The Evaluation of Liquidated Damage Provisions

Courts will enforce liquidated damage provisions in contracts if the stipulated damages payments are designed to compensate the non-breaching party for the economic consequences of the breach, but not if the stipulated damages are designed as a penalty to coerce compliance with the terms of the agreement or to punish a breaching party. *See Restatement (Second) of Contracts* § 356 (“Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy.”) (emphasis added). Comment a to this section of the Restatement provides that:

[T]he parties to a contract are not free to provide a penalty for its breach. The central objective behind the system of contract remedies is compensatory, not punitive. Punishment of a promisor for having broken his promise has no justification on either economic or other grounds and a term providing such a penalty is unenforceable on grounds of public policy.

Id. (emphasis added).

Missouri law, which governs the UP/M&NA Lease,¹⁴ has long refused to enforce penalty provisions and has relied upon the Restatement to support this policy. *See, e.g., Abrams v. St. Louis County Library Dist. Board*, 258 S.W.2d 672, 675 (Mo.

¹⁴ *See* Section 23.07 (“This Lease shall be governed and construed in accordance with the laws of the State of Missouri.”).

1953) (“The conclusion of the [trial] court that the provisions of the lease, especially those contained in clause 4, *supra*, rendered the \$20,000 stipulated as damages for *any* breach of the lease a penalty rather than liquidated damages is supported by good authority.”); *id.* (“In view of the fact that a breach of any covenant in the lease, no matter how great or how trivial, would result in the forfeiture of the entire \$20,000, and the clear provision of the lease that the lessor may retain the deposit as damages while holding the lessee to liability for loss of rental to the end of the term, it is inescapable that the provision is for a penalty rather than liquidated damages.”); *Diffley v. Royal Papers, Inc.*, 948 S.W.2d 244, 246 (Mo. Ct. App. 1997) (citing Section 356 of the Restatement and explaining that “in determining whether an agreement sets forth a penalty or liquidated damages, we look to the intention of the parties as ascertained from the contract as a whole”); *id.* at 247 (“The provision must be fixed on the basis of compensation, otherwise it is construed as a penalty clause designed primarily to compel performance.”); *Muhlhauser v. Muhlhauser*, 754 S.W.2d 2, 5 (Mo. Ct. App. 1988) (“[S]uch a provision clearly does not measure compensation for breach but rather provides a punishment. Therefore, this court holds the penalty provision invalid and unenforceable.”).

In one case of particular relevance to the instant dispute, a Missouri court declined to enforce a penalty provision that the parties attempted to disguise in the form of escalating “rent” levels that a tenant railroad would be required to pay for failing to

comply with the terms of the agreement. In particular, in *Muehlebach v. Missouri & K.I. Ry.*, 148 S.W. 453 (Mo. Ct. App. 1912), the Missouri appellate court considered a situation in which a railroad company entered into a contractual relationship that ultimately required the relocation of the railroad's line. Significantly, the parties' agreement provided that if the railroad delayed its line relocation, it would be obligated to pay "rent" to the plaintiff in monthly amounts that would increase over time. *Id.* at 455 ("defendant should pay a rental of \$50 per month to plaintiffs for the right of way on that tract until the removal of the road. If the road was not removed by the end of the first six months, the rental for the next six months was to be \$75 per month; for the third six months, \$125; for the fifth, \$175; for the sixth, \$225; and so on indefinitely, increasing the rental \$50 per month for each additional period of six months."); *id.* at 456 ("And if defendant should remain five years longer, it would have to pay about \$40,000 more for the use of a right of way the entire value of which for all time was assessed at \$2,540 in the condemnation suit. For the next ten years the rental would be over \$160,000.").

The court recognized that the purpose of the ostensible "rental" provision of the contract actually was to coerce the defendant into compliance with the movement of its line and to punish the defendant for failing to do so. As a result, the court concluded that the rental provision would not be enforced:

Was the so-called "rental agreement" in legal intendment a penalty intended to coerce performance of the contract? If it was, it cannot be enforced. 2 *Page on Contracts*, § 1167 et seq. "A contract for a penalty," says this author, "is an

agreement to pay a stipulated sum in case of default, intended to coerce performance, to punish default, or to secure payment of the actual damages. A contract for liquidated damages is a contract by which the parties in advance of breach fix the amount of damages which will result therefrom and agree upon its payment.” Whether the stipulated payments of so-called “rent” should be classed as a penalty or as liquidated damages for the nonperformance of the agreement of defendant to vacate “tract A” is a question of law for the court to solve in the light of the subject-matter of the contract and the intention of the parties. *May v. Crawford*, 150 Mo., loc. cit. 530, 51 S.W. 700.

. . . It is manifest the stipulation in question was not intended as a letting of “tract A” or to create the relation of landlord and tenant between plaintiffs and defendant, and it is a misnomer to speak of the stipulated payments as a rental. The parties intended that “tract A” should be vacated just as soon as the new terminal could be established, and the obvious purpose of providing a progressively increasing scale of monthly payments was to coerce defendant into a speedy vacation of the right of way over that tract and to impose an interminable and ever increasing punishment for a breach of the stipulation, a punishment so harsh and oppressive, so disproportionate to the subject-matter of the stipulation, as to preclude the thought that the parties had in mind the liquidation of the reasonable damages that would be sustained by plaintiffs in consequence of a breach by defendant. The stipulation for damages must be regarded as a penalty, and therefore as non-enforceable.

Id. at 456-57 (emphasis added); *see also id.* at 457 (“Plaintiffs are entitled to recover in this action on account of defendant’s breach, but the measure of their damages is the actual loss sustained by them in consequence of defendant’s occupation of ‘tract A.’”).

Much like the improper rental provision in *Muehlebach*, the rental provision in the UP/M&NA Lease seeks to coerce M&NA to refrain from specified

behavior and to punish M&NA for failing to do so. The Board should follow the example of the Missouri courts and find that such provisions are contrary to public policy.

b. Covenants Not to Compete

A second area of law that provides some insight into the reasonableness of the UP/M&NA Lease relates to covenants not to compete, which can arise in the context of employment agreements or agreements regarding the sale of a business. In this regard, Missouri courts have held that “[i]n determining the enforceability of covenants not to compete which are ancillary to the sale of a business or employment contract, courts have resorted to a ‘reasonableness’ standard. In this context, ‘reasonableness’ has been interpreted as requiring a balancing of the countervailing interests of the promisor, the promisee, and the public good.” *Schnucks Twenty-Five, Inc. v. Bettendorf*, 595 S.W.2d 279, 285 (Mo. Ct. App. 1979) (citing *Hinderer, Covenants Not to Compete – Enforceability Under Missouri Law*, 41 Mo. L. Rev. 37, 40 (1976)). Further explaining the nature of the applicable reasonableness test, the Missouri court stated that “[a] restrictive covenant [imposing a territorial limitation on opening a business] will be upheld if the area to which it refers is not larger than that reasonably necessary to protect the covenantee.” *Id.* at 286 (emphasis added).

Likewise, in *Systematic Business Services, Inc. v. Bratten*, 162 S.W.3d 41 (Mo. Ct. App. 2005), the Missouri court held that “[a]n employer cannot extract a

restrictive covenant from an employee merely to protect itself from competition, but a limited time and geographical restraint may be deemed reasonable and enforceable if the employer's legitimate protectible interests, such as 'stock of customers' and the company's goodwill, are served." *Id.* at 49 (emphasis added). The court added that "[t]he standard for determining the reasonableness of the geographic scope of a restrictive covenant is whether it is no greater than fairly required for protection." *Systematic Business*, 162 S.W.3d at 49-50 (emphasis added); *see also H&R Block Eastern Tax Services, Inc. v. Enchura*, 112 F. Supp. 2d 1067, 1072 (W.D. Mo. 2000) ("Covenants against competition must serve a proper interest of the employer in protecting the good will of a business, and must be reasonably limited in time and space.") (quoting *Osage Glass, Inc. v. Donovan*, 693 S.W.2d 71, 75 (Mo. 1985) (*en banc*)).

Missouri courts have emphasized that "non compete agreements are not favored in the law." *Renal Treatment Centers – Missouri, Inc. v. Braxton*, 945 S.W.2d 557, 564 (Mo. Ct. App. 1997) (citing *ARR-EMF, Inc. v. Passmore*, 906 S.W.2d 714, 719 (Mo. Ct. App. 1995)); *see also Sturgis Equipment Company, Inc. v. Falcon Industrial Sales Co.*, 930 S.W.2d 14, 16 (Mo. Ct. App. 1996) ("Covenants not to compete are not favored in the law."); *id.* at 17 ("Generally, to determine whether a restriction is reasonable, courts inquire into whether it is no greater than fairly required for the protection of the party seeking to enforce it." (emphasis added) (citing *Continental Research Corp. v. Scholz*, 595 S.W.2d 396, 400 (Mo. Ct. App. 1980))).

The paper barrier restrictions in the UP/M&NA Lease are greater { [REDACTED] } than would be necessary to protect the stream of contribution that UP would lose through the diversion of traffic. As a result, Missouri law confirms that this “disfavored” provision is not reasonable.

4. Continued Enforcement of the Lease’s Rent Provision is Improper

The continued enforcement of the paper barrier provisions in the UP/M&NA Lease is improper because the restriction is designed to coerce interchange with UP and/or to punish traffic diversion, rather than simply to preserve the revenue stream that UP would have received had it not divested/leased the rail facilities in question. *See* Ex Parte No. 575 at 10-11. Moreover, the paper barrier in the UP/M&NA Lease would yield a substantial windfall to UP in the event that M&NA interchanged traffic with a carrier other than UP. This type of restriction is fundamentally inconsistent with the suggestion that a paper barrier merely prevents the loss of pre-transaction value associated with the line. *Id.* at 10-11 (“The revenue stream resulting from the agreement should be no more than what the carrier would have received had it not divested or leased the rail facilities in question . . .”).

It would have been entirely possible for UP to structure its lease with M&NA in a manner that – while not constituting an unreasonable practice – nevertheless would have permitted UP to benefit from labor- and maintenance-related cost savings and would have allowed UP to ensure that it would not be deprived of its pre-transaction

GCV. To that end, UP could have developed a rental provision that included a more modest interchange obligation and established a less onerous annual rental level that would have approximated the economic impact expected to be associated with traffic diversion. The UP/M&NA Lease, however, violates public policy because the net result of the 95% traffic obligation, the \$90+ million annual rental payment, and the lower rental amounts for the varying percentages of traffic interchanged with UP, go well beyond the levels that would be necessary to ensure that UP would preserve its pre-transaction GCV.

UP certainly understood that its approach to the M&NA transaction carried a risk of being found to be “unlawful or otherwise improper” (*see* UP/M&NA Lease at Section 15.01(f)), but UP elected to take this risk. Rather than fashioning a rental provision and/or interchange limitation that fairly compensated UP for any lost contribution, UP instead intentionally imposed a rental obligation upon M&NA that UP knew would coerce M&NA’s interchange with UP and would punish M&NA if it violated this interchange obligation. M&NA, for its part, agreed to the Lease with the full understanding that it would never be able to transport substantial volumes in conjunction with a long-haul carrier other than UP. M&NA, of course, was in no position to place demands upon UP regarding the proper level of the rental obligation.¹⁵

¹⁵ { [REDACTED]

As recounted above, UP's Mr. Warren Wilson { [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

In his accompanying Verified Statement, Mr. Thomas D. Crowley analyzes data produced in discovery by UP to calculate the pre-transaction Going Concern Value of the Line, the pre-transaction estimate of the value of the lease, and the actual value of the lease as demonstrated by fifteen years of experience thereunder. Mr. Crowley also calculates the degree of overcompensation that the rental provision would afford under several different hypothetical traffic diversion scenarios.

Mr. Crowley's analysis confirms that UP expected the M&NA transaction to increase the economic value of the Line, and that { [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] } In particular, Mr. Crowley shows that the pre-transaction GCV of the Line was **{ [REDACTED] }**, and that UP's pre-transaction estimate of the value of the lease/sale transaction was **{ [REDACTED] }**. Crowley V.S. at 11. Furthermore, Mr. Crowley demonstrates that UP's actual NPV of the revenue stream from the lease/sale has been approximately **{ [REDACTED] }** through 2007. *Id.*

Mr. Crowley also confirms that the diversion of traffic under the lease would have resulted in substantial overcompensation of UP. Under any traffic routing scenario that the parties reasonably could have anticipated prior to the execution of the lease, UP's imposition of this rental provision ensured that it would obtain profits that were greater (and in some cases substantially greater) than it would have received in the absence of the lease.

In his statement, Mr. Crowley calculates the net benefit to UP (on a present-value, pre-transaction basis) of the following traffic diversion scenarios: (a) diversion of Entergy traffic; (b) diversion of KCPL traffic; and (c) diversion of traffic that UP handles as a bridge carrier. *See* Crowley V.S. at 12-17. In each instance, Mr. Crowley determines that the pre-transaction net present value of the transaction would have increased very substantially in the event that UP had assumed the diversion of traffic to a rival Class I carrier. *Id.* Specifically, Mr. Crowley calculates that the net present value of the transaction would have increased above the **{ [REDACTED] }** pre-

transaction GCV by { [REDACTED] }, respectively, in these three diversion scenarios. *Id.* at 17.

These examples provide further confirmation that the paper barrier rental provision in the UP/M&NA Lease was not designed to protect the pre-transaction GCV value of the Line, but instead, was designed to punish M&NA for the interchange of traffic with a rival Class I carrier.

5. The Board's Determination Should Consider the Potential Public Policy Impact of { [REDACTED] }

{ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] }

{ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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[REDACTED]

[REDACTED] } In *Central Oregon & Pacific Railroad, Inc – Coos Bay Rail Line*, Finance Docket No. 35130, RailAmerica and Central Oregon & Pacific Railroad, Inc. (“CORP”) have complained that UP’s control over the pricing of traffic that CORP handles as a switching carrier prevents CORP from covering the increases in its operating expenses or performing extraordinary maintenance:

Under the terms of a “Cooperative Marketing Agreement” entered into between CORP and SP in connection with the line sale transaction, CORP handles the vast majority of the traffic moving over the Coos Bay Line as a “switching carrier” for UP. . . . Under this arrangement, the traffic moves under a UP waybill, and UP has sole authority to determine the rate for the movement (including the portion over CORP’s lines). . . .

Thus, unlike Class I railroads (and many shortline carriers), CORP does not control the pricing of the vast majority of the traffic that moves over its lines. Rather the rates on such shipments are established by (and accrue to) UP, with CORP being paid a fixed fee for handling the traffic

to/from Eugene, OR. As a result, CORP does not have the ability to take pricing actions that would generate additional revenue for upgrading or expansion of its rail infrastructure. . . [A]nnual increases [in the Handling Carrier Charge paid to CORP] have not been sufficient to cover fully the increase in normal operating expenses for the Coos Bay Line (much less to fund extraordinary capital improvements).

See Central Oregon & Pacific Railroad, Inc. – Coos Bay Rail Line, STB Finance Docket No. 35130, Response of RailAmerica, Inc. and Central Oregon & Pacific Railroad, Inc. to Order to Show Cause (Public Version) (filed May 12, 2008), Verified Statement of Paul Lundberg at 3-4; *see also id* at 11 (“UP’s outright refusal to contribute to a long-term solution for the Coos Bay Line indicates that UP is not concerned by the prospect of losing the traffic generated by shippers on the line (who are UP’s customers).”).

{ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] }

In its Ex Parte No. 575 decision, the Board suggests that in order to “assess the public interest, [it will] weigh the benefits of a particular interchange commitment

against its potential for harm.” *Id.* at 8. Entergy respectfully requests that, in performing this assessment, the Board consider the potential detriment to the public interest associated with the terms of a paper barrier restriction { [REDACTED] }

B. In the Alternative, the Board Should Revoke the Exemption in Part

Section 10502 of Title 49 provides that “[t]he Board may revoke an exemption, to the extent it specifies, when it finds that application in whole or in part of a provision of this part to the person, class, or transportation is necessary to carry out the transportation policy of section 10101 of this title.” These section 10101 policies include the promotion of “effective competition among rail carriers.” 49 U.S.C. § 10101(4).

To justify revocation, a petitioner must demonstrate reasonable, specific concerns addressing the need for regulation. *See, e.g., The Columbus & Ohio River Rail Road – Acquisition and Operation Exemption – Rail Line of CSX Transp, Inc.*, STB Finance Docket No. 34540 (STB served Nov. 18, 2005); *Wisconsin Central Ltd. – Exemption Acquisition and Operation – Certain Lines of Soo Line Railroad Company*, STB Finance Docket No. 31102 (ICC served July 28, 1988); *I&M Rail Link LLC – Acquisition and Operation Exemption – Certain Lines of Soo Line Railroad Company d/b/a Canadian Pacific Railway*, STB Finance Docket No. 33326 *et al* (STB served Apr. 2, 1997); *Minnesota Comm. Ry., Inc. – Trackage Exempt. – BN R.R.*, 8 I.C.C.2d 31 (1991).

The Board has been willing to invoke its revocation authority in the past when considering claims regarding the transfer of a rail line. *See, e.g., SF&L Ry. – Acquisition and Operation Exemption – Toledo, Peoria and Western Ry Between La Harpe and Peoria, IL*, STB Finance Docket No. 33995 (STB served Oct. 17, 2002) (“We will not allow our class exemption processes to be abused by sales of active rail lines to persons whose intent is to degrade, abandon, and salvage those lines.”); *id.* (“We understand that our decision to revoke the exemptions could be viewed as producing unnecessary turmoil, [but] . . . no party to the sale should be allowed to profit from the tactics that were employed in this case.”); *Riverview Trenton R.R. – Acquisition and Operation Exemption – Crown Enterprises, Inc.*, STB Finance Docket No. 33980 (STB served Feb. 15, 2002) (“We will revoke the exemption . . . because this proposal warrants more detailed scrutiny than is afforded by the existing record.”); *Land Conservancy of Seattle and King County – Acquisition and Operation Exemption – The Burlington Northern and Santa Fe Ry.*, 2 S.T.B. 673 (1997) (“The facts here support the conclusion that TLC never had any intention of reinstituting rail service on the line.”).

Entergy respectfully submits that if the Board declines to find that continued enforcement of the lease’s paper barrier terms would be an unreasonable practice, revocation of the exemption in Finance Docket No. 32187 is appropriate to the limited extent necessary to preclude the continued enforcement of the paper barrier restrictions. The considerations expressed by Mr. Mohl regarding the construction of a

rail spur from Independence to the BNSF's line are particularly relevant to the revocation of the exemption. In particular, relief in this proceeding would help to foster the national rail transportation policy and to benefit the public interest by alleviating the need to construct redundant rail facilities. *See Mohl V.S.* at 8-9.

C. **The UP/M&NA Lease Constitutes an Unapproved Pooling Arrangement**

A third, independent basis exists for precluding further enforcement of the UP/M&NA Lease's paper barriers. In particular, Section 11322 of Title 49 provides that "[a] rail carrier providing transportation subject to the jurisdiction of the Board under this part may not agree or combine with another of those rail carriers to pool or divide traffic or services or any part of their earnings without the approval of the Board under this section or section 11123 of this title." 49 U.S.C. § 11322(a). Section 11322 further states that the Board "may impose conditions governing the pooling or division" and that the Board "may begin a proceeding under this section on its own initiative or on application." *Id.* at § 11322(b) & (c).

Under the terms of § 11322, the Board may approve and authorize an agreement or combination if the rail carriers involved assent, and if the Board finds that "a pooling or division of traffic, services, or earnings – (1) will be in the interest of better service to the public or of economy of operation; and (2) will not unreasonably restrain competition." *Id.* at § 11322(a).

Under the terms of the UP/M&NA lease, the two carriers have agreed that M&NA will interchange virtually all of its traffic with UP, rather than with other carriers having the physical capability to interchange with M&NA. While UP and M&NA certainly assented to the arrangement reflected in their lease, the Commission at the time did not find that the pooling or division of traffic and/or services by the carriers would be in the interest of better service or economy of operation and would not unreasonably restrain competition.

The United States Court of Appeals for the Seventh Circuit previously found that a long-standing contractual arrangement involving switching service in Peoria, Illinois was invalid because of the absence of specific ICC approval for the pooling arrangement. In particular, in *Chicago & N.W. Ry. v. Peoria & P.U. Ry.*, 319 F.2d 117 (7th Cir. 1963), the Seventh Circuit found that a 1911 contract between the Chicago and North Western Railway Company ("North Western") and the Peoria and Pekin Union Railway Company ("P&PU") had not received proper approval from the Commission and therefore was invalid.

Under the terms of the North Western/P&PU contract, North Western was prohibited from offering switching service in the defined geographic area, but instead, was obligated to give all of its freight and service to P&PU. This limitation "would prohibit plaintiff from serving industries accessible to its lines and from establishing interchange connections with any other railroad for its own account." *Id.* at 121; *id.*

(“Thus, the contract, in that respect constitutes an agreement not to compete in P.&P.U.’s area of operations in terminal delivery or interchange traffic, and not to compete with P.&P.U. in the matter of soliciting for its own account or fixing rates for traffic moving in the Peoria-Pekin area.”). On the basis of this limitation, the trial court had found that the contract constituted a pooling agreement within the meaning of Section 5(1) of the Interstate Commerce Act “to the extent that it purports to reserve to P.&P.U. all terminal and intermediate switching service within the Peoria vicinity and to reserve to P.&P.U. all freight originating or terminating on its lines.” *Id.*

The dispute presented to the Seventh Circuit involved an effort by North Western to interchange traffic with the Toledo, Peoria and Western Railroad Company (“TP&W”) in the vicinity of Peoria, and thus in contravention of the terms of the 1911 contract between North Western and P&PU. The court concluded that the agreement at issue constituting a pooling agreement, and that approval had not been granted by the ICC. In reaching this conclusion, the court rejected the claim that the needs of the terminal railroad industry should be regarded as paramount and should override any concerns regarding the agreement:

P&PU argues that the terminal railroad business is a substantial industry in its own right and that its needs are paramount. A good answer to such a contention appears in *Greater Boston Rouge Port Commission v. United States of America*, 5 Cir., 287 F.2d 86, 95: ‘No matter how desirable an agreement may appear, no matter how beneficent the monopoly may appear, Congress has commanded that agreements limiting or destroying competition must first be

approved by the (Commission) before they may be lawfully carried out. National policy favors free and healthy competition; monopoly is the exception.

Id. at 122; *see also id.* (“We also agree with the District Court that the contested provisions of the 1911 contract violate Section 1 of the Sherman Act. If the contested clause of the contract was sustained, North Western would be required to deliver to P&PU all traffic destined to industries or other roads at or near Peoria and there would be reserved to P&PU all business originating or terminating at industries on its line. . . . For these competitors to determine among themselves that all this traffic will move by P&PU is a per se violation of the Sherman Act.”).

Like the pooling agreement in *North Western v. Peoria*, the agreement between UP and M&NA restricts traffic and service in a manner that effectively precludes interchange with a carrier other than UP. Under the UP/M&NA Lease, M&NA is effectively obligated to interchange at least 95% of its eastern and western traffic with UP or to suffer the penalty associated with the rent provision. Through this provision and UP’s right to provide exclusive service to Independence on seven days’ notice, the Lease prevents competition between UP and BNSF/M&NA to serve Entergy. *See North Western v. P&PU*, 319 F.2d at 121 (“We agree with the District Court that North Western and P&PU are competitive at Peoria.”). Entergy therefore requests that the Board find that: (i) the UP/M&NA Lease constitutes a pooling arrangement; and (ii) approval for

the continued applicability of the lease only be provided subject to the condition that UP not enforce the paper barrier restrictions set forth in the lease.

The exemption process through which M&NA obtained authorization to operate the Line cannot, in any sense, be regarded as satisfying the statutory obligation for the agency to approve pooling arrangements. To the contrary, the exemption that M&NA invoked related to the provisions of 49 U.S.C. § 10901, and the Commission found – in response to a petition to revoke filed by rail labor – that the acquisition exemption related to Chapter 109 of Title 49. *See Missouri & Northern Arkansas R.R. – Lease, Acquisition and Operation Exemption – Missouri Pacific R.R. and Burlington N. R.R.*, ICC Finance Docket No. 32187, 1993 WL 138262, at *1 (ICC served May 4, 1993) (“The law is well-settled that the acquisition of a line of railroad and incidental trackage rights by a noncarrier, as here, is governed by section 10901, not 11343.”).

VI. REQUEST FOR RELIEF

As described above, since this is a case of first impression before the Board, broad discretion exists with regard to the specific relief that the Board may impose upon a finding that the continuation of the status quo under the lease is contrary to the public interest. Entergy therefore has endeavored to develop a number of different potential forms of relief that would be appropriate:

A. Paper Barrier Preclusion

In the first instance, Entergy requests that the Board simply preclude UP's continued enforcement of the paper barrier restrictions. This type of relief would leave the UP/M&NA Lease in effect, but would prevent UP from enforcing the rental obligation under the lease. As Entergy demonstrates herein, that rental obligation violates public policy because it acts as a penalty to punish M&NA's diversion of traffic, rather than merely to compensate UP for the loss of contribution associated with traffic diversion.

In addition, this type of relief should prevent UP from exercising its right under Sections 3.01 and 3.04 of the lease to provide exclusive service to the Independence Station via trackage rights, absent Entergy's request { [REDACTED] [REDACTED] [REDACTED] }. In the absence of Entergy's concurrence, this provision otherwise would allow UP to preclude any diversion of Independence traffic, even during times in which UP is unable or unwilling to provide service at the level requested by Entergy and even absent enforcement of the rental provision.¹⁶

¹⁶ As indicated above, it is imperative that the Board not disturb Entergy's right to insist that UP provide direct service to Independence in the absence of M&NA. This right is set forth both in Section 3.01 of the UP/M&NA Lease itself ("Lessor may obtain trackage rights . . . either at AP&L's request or at Lessor's sole discretion") { [REDACTED] [REDACTED] }.

Finally, this type of relief should prevent UP from exercising its right under Section 15.01(f) to terminate the lease upon the finding that the provisions of Section IV are unreasonable. UP designed Section 15.01(f) to insulate itself from the consequences of the brinksmanship in which it had engaged when creating the onerous paper barrier. As Entergy's evidence demonstrates, UP already has obtained a greater financial benefit through its lease and paper barrier restriction than the pre-transaction GCV. Moreover, the Line will continue to generate additional contribution for UP even in the absence of the paper barrier restriction. For example, UP will receive additional contribution from, *e.g.*: (i) traffic on the Line that only UP is able to originate (or deliver); (ii) traffic on the Line that is subject to an ongoing contract with UP; or (iii) situations in which UP's service quality and rate offerings are more attractive for shippers than what may be available from competing carriers.

B. Paper Barrier Preclusion with UP Right to Terminate

Entergy respectfully submits that an alternative form of relief also would be appropriate in this case. In particular, if the Board determines that continued enforcement of the paper barrier provisions would be contrary to the public interest, then the Board could preclude continued enforcement of the rental and trackage rights provisions (subject again to Entergy's right to insist upon exclusive UP service to Independence), but could allow UP the option to terminate the lease and return to its pre-transaction status quo with respect to the leased property.

In the event that UP elected to terminate the 1992 UP/M&NA Lease, UP then would have the option either to restore its own service over the leased portions of the Line or to negotiate a new lease of this property.¹⁷ Operations conducted pursuant to a new lease would be subject to:

(1) a Board determination that the revised lease is consistent with the public interest (*i e* , whether any proposed interchange restriction acts as compensation or as a penalty), made on the basis of its own review and comments from the public (after review of the proposed lease terms); or

(2) To the extent that the Board does not believe that it is appropriate or efficient for it to enter into a detailed examination of the financial impact of the proposed lease agreement, the Board instead could presume that the proposed replacement lease would be reasonable (as in past exemption transactions involving 49 U.S.C. § 10901) unless shippers who generated at least fifty-one percent of the carloads that originated or terminated on the Line over the preceding twelve months submit comments objecting to the proposed new lease (to be submitted within thirty days after UP's disclosure of the proposed lease).

Drs. Kwoka and Warren-Boulton address this form of relief in their statement, explaining that the "Shipper Right of Approval" or "SRA" presents an effective means of ensuring that a paper barrier restriction is not unreasonable. *See*

¹⁷ This would require UP either to repurchase the portion of the Line that M&NA purchased in 1992, to obtain rights from M&NA to operate over such portion, or to make arrangements for M&NA to operate over such portion.

Kwoka/Warren-Boulton V.S. at 9-13. Effectively, this option would allow the Board to evaluate the public interest through the surrogate of the actual shipping public itself, which will be in the best position to determine whether its transportation interests are better served by UP acting alone or by a lease arrangement through which UP maintains some more limited degree of control over interchange. As Drs. Kwoka and Warren-Boulton explain, there are a number of advantages associated with this type of relief:

One important advantage of SRA, relative to alternatives, is its administrative simplicity. It does not require regulatory scrutiny of filings by self-interested parties, especially those with asymmetric access to information. It does not require regulatory intervention into private decision-making. It does not involve outsiders' judgments about the appropriate length or scope of the restriction. It does not require agency prescription of the level of compensation. It would avoid endless debate about which barriers may be reasonable and which are not. The parties with the best knowledge and greatest interest in the outcomes resolve the matter themselves, with the SRA ensuring movement of the asset toward (if not necessarily all the way to) the optimum allocation. In effect, the SRA would permit and facilitate a market-efficient outcome.

Kwoka/Warren-Boulton V.S. at 12-13. This option has the added virtue of allowing UP, the short line carrier, and the shipping public to arrive at a situation that each prefers as compared with the restoration of UP service on the line.

The Board has long expressed a preference for allowing interested parties to resolve issues through private negotiations, rather than leaving all issues for resolution by the agency. *See, e.g., Canadian National Ry. – Control – Illinois Central Corp.*, STB

Finance Docket No. 33556 (STB served May 25, 1999) at 59 (Chairman Morgan, Commenting) (“[T]he Board has moved away from interjecting itself into the arbitral process and, rather, has emphasized its strong preference for voluntary private-sector resolution of issues such as labor matters.”); *id.* (“These efforts to encourage negotiation rather than arbitration have produced significant results.”); *id.* at 60 (“Beyond labor matters, I also applaud the applicants and various other parties for working to reach privately negotiated settlement agreements. . . . These agreements also are in line with the Board’s continuing emphasis on private-sector resolution.”) (emphasis added); *Granite State Concrete Co v. Boston and Maine Corp.*, STB Docket No. 42083 (STB served Sept. 15, 2003), at 8 (“This dispute would seem to be a good candidate for resolution pursuant to private negotiation between the parties . . .”).

In fact, as indicated above, the Board has expressed a preference for private resolution even in the context of the Ex Parte No. 575 proceedings (which led to the Board’s reliance on the RIA in the paper barrier context). *See Review of Rail Access and Competition Issues*, STB Ex Parte No. 575 (STB served May 4, 1998), at 4 (“[W]e continue to believe that some common ground can be reached if all parties can put aside their preconceived notions and enter negotiations with an open mind, committed to seeking some common ground rather than immediately assuming that governmental fiat is the only answer or that more litigious avenues must be pursued.”) (emphasis added); *see also Review of Rail Access and Competition Issues*, STB Ex Parte No. 575 (STB

served April 17, 1998), at 4 n.4 (“Initial reliance on negotiations among the interest groups that are directly affected by our regulatory policies is neither inappropriate nor without precedent.”) (emphasis added) (citing *The Staggers Rail Act of 1980 – Conference of Interested Parties*, ICC Ex Parte No. 456).

The type of relief that Entergy seeks in this respect is entirely consistent with the Board’s prior expressed preference for allowing private interests to resolve disputed matters.

**C. Bottleneck Rate Relief/Rent Relief for
Traffic Moving Pursuant to Prescribed Rates**

Finally, and further in the alternative, Entergy submits that the Board also should: (i) confirm M&NA’s obligation to provide a common carrier rate from a point of interchange with a long-haul carrier other than UP with whom Entergy enters into a contract; (ii) allow Entergy to pursue a bottleneck stand alone cost case against M&NA that need not include costs associated with the paper barrier in calculating the Board’s jurisdictional threshold; and (iii) excuse M&NA from any rental obligation to the extent it provides service in accordance with a rate prescribed through such a stand alone cost case.

This type of relief is consistent with the Board’s comments in Ex Parte No. 575 regarding the supposed equivalence of the pre- and post-lease competitive situations involving captive shippers. *See* Ex Parte No. 575 (STB served Oct. 30, 2007) at 8-9. Specifically, the Board explained that the presence of a paper barrier should not be an

impediment to the use of a through route involving the tenant carrier if a shipper obtains an upstream contract with a third-party carrier:

And, just as before the sale or lease, if the shipper enters into a contract with Carrier Z, it would have the right to use the competing through route, notwithstanding any private interchange commitment.

Id. at 9.

Prior to the transaction, a shipper with an upstream contract with a competing carrier would be able to seek bottleneck rate relief against the destination monopolist. *See Central Power & Light Co. v. Southern Pacific Transp. Co.*, ICC Docket No. 41242 (ICC served Dec. 31, 1996) at 14 (“[I]n a complaint against a bottleneck proportional rate that operates in combination with a contract rate, we conclude that, in light of section 10709(c)(1), we may consider only the reasonableness of the bottleneck rate”). That type of bottleneck rate case would develop stand-alone costs for the movement from the point of interchange to the destination, and would develop variable costs for the movement from interchange to destination as well. In order for a post-transaction bottleneck rate case to mirror the competitive situation prior to the lease (as the Board’s argument in Ex Parte No. 575 suggests would be the case), however, the bottleneck rate case initiated against the lessee must exclude consideration of any paper barrier rental provision when calculating variable costs. Only in that type of analysis would the shipper have the ability to challenge a rate to be used in conjunction with third-party contract carrier service in a manner that is equivalent to the pre-lease

situation. The relief that Entergy seeks in this respect would ensure that the Board preserves a shipper's right to challenge a destination monopolist's rate on the same basis that existed prior to the paper barrier transaction.

Respectfully submitted,

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Dated: July 11, 2008

Attorneys & Practitioners

CERTIFICATE OF SERVICE

I hereby certify that I have this 11th day of July, 2008, caused copies of the foregoing Opening Evidence and Argument to be served upon the parties of record to this case as follows:

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Andrew B. Kolesar III

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**ENTERGY ARKANSAS, INC. and
ENTERGY SERVICES, INC., Complainants**

v.

**UNION PACIFIC RAILROAD
COMPANY and MISSOURI &
NORTHERN ARKANSAS RAILROAD
COMPANY, INC., Defendants.**

Docket No. 42104



**MISSOURI & NORTHERN ARKANSAS
R.R. – LEASE, ACQUISITION AND
OPERATION EXEMPTION – MISSOURI
PACIFIC R.R. and BURLINGTON N. R.R.**

Finance Docket No. 32187

**ENTERED
Office of Proceedings**

JUL 11 2008

**Part of
Public Record**

COUNSEL'S EXHIBITS

***REDACTED, PUBLIC VERSION
– MATERIAL UNDER SEAL DELETED –***

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Dated: July 11, 2008

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COUNSEL'S EXHIBITS (Public Version)

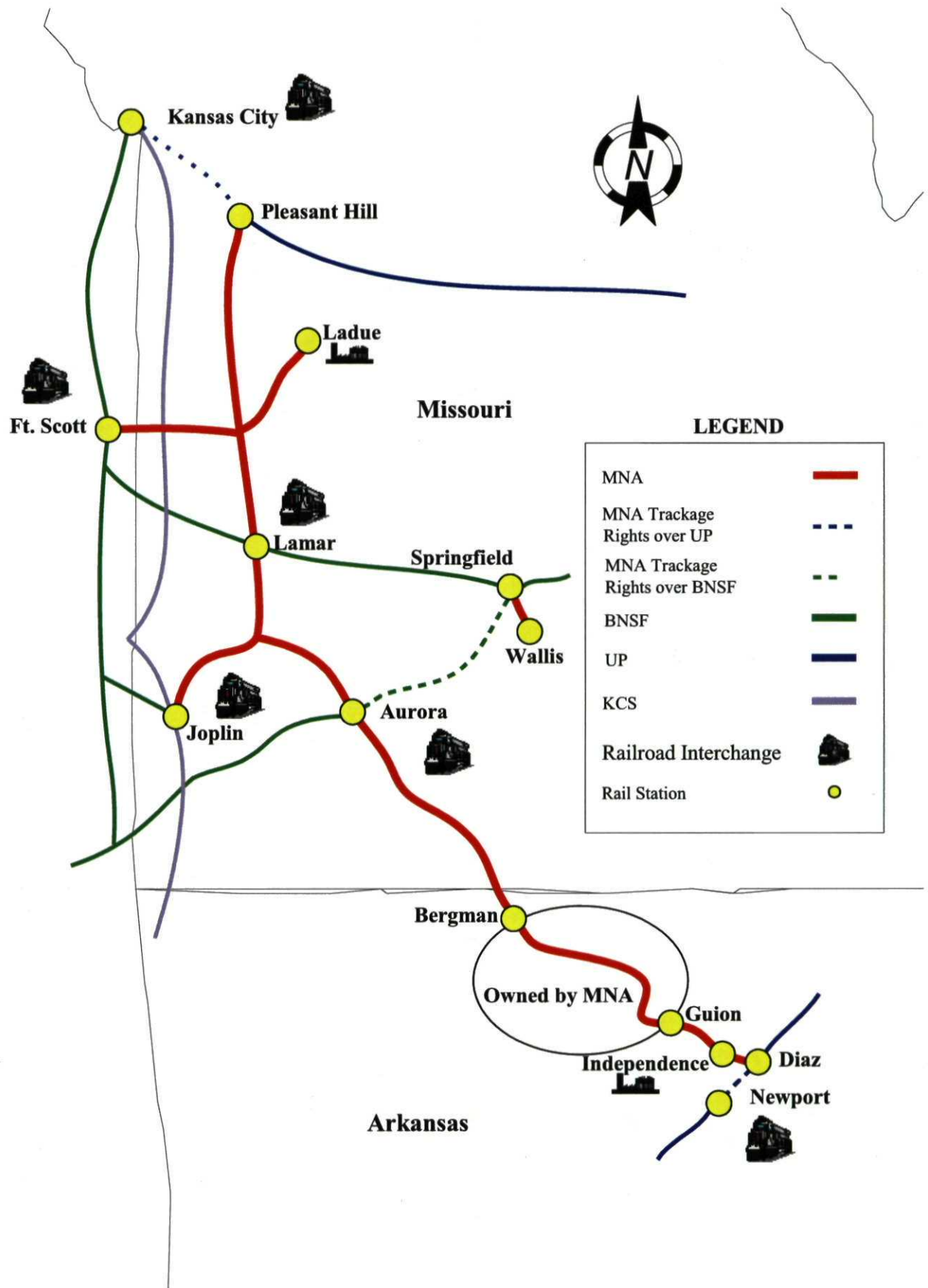
- 1 UP/M&NA Lease (Redacted)
- 2 Map of M&NA Line
- 3 Map of 1980's Route of Movement
- 4 Map of 1989-1998 Route of Movement
- 5 Map of 1998-Present Route of Movement
- 6 May 27, 1993 Agreement between Entergy and UP (Redacted)
- 7 UP's 1992 Approval for Line Disposition Analysis (Redacted)
- 8 Entergy's Discovery Request No. 12 to M&NA
- 9 M&NA's Response to Entergy's Discovery Request No. 12
- 10 Vice Chairman Mulvey's Written Testimony to Congress dated
September 20, 2007
- 11 Special Board of Adjustment Decision (1993) (Redacted)
- 12 Warren C. Wilson Deposition Transcript (Redacted)
- 13 UP's 1992 Economic Analysis including APL revenues and costs
(Redacted)
- 14 Supplemental Agreements to the UP/M&NA Lease (Redacted)
- 15 Handwritten M&NA Notes (1994) (Redacted)
- 16 M&NA Letter to UP dated October 6, 2006
- 17 M&NA Letter to Entergy dated October 13, 2006
- 18 Rep. Sensenbrenner/DOJ correspondence July 15 & Sept. 27, 2004
- 19 M&NA Financial records (Redacted)

**COUNSEL'S EXHIBIT
NO. 1**

REDACTED

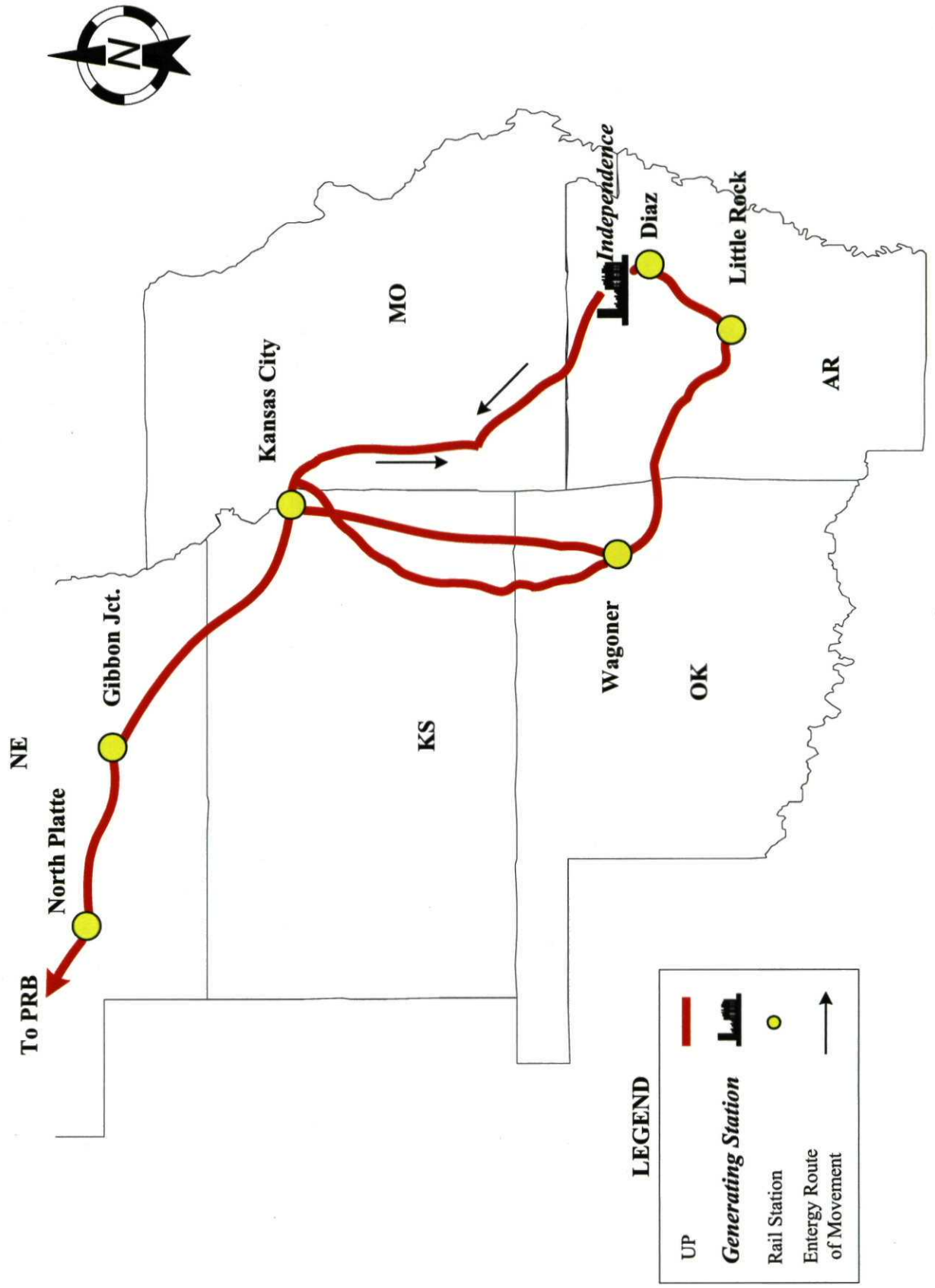
**COUNSEL'S EXHIBIT
NO. 2**

Schematic of M&NA



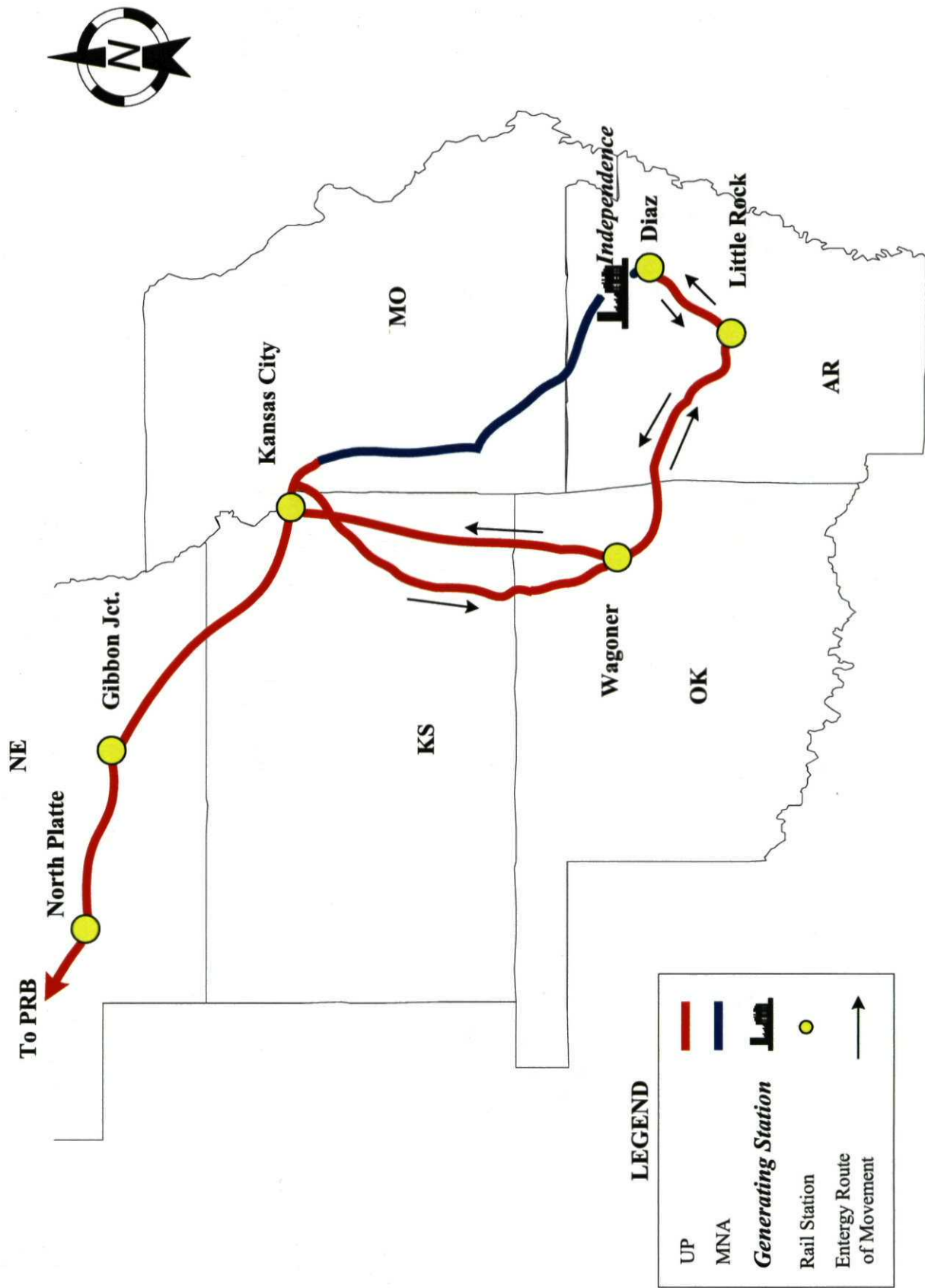
**COUNSEL'S EXHIBIT
NO. 3**

Schematic Of UP's Route From PRB To Entergy's Independence Generating Station (1980's)



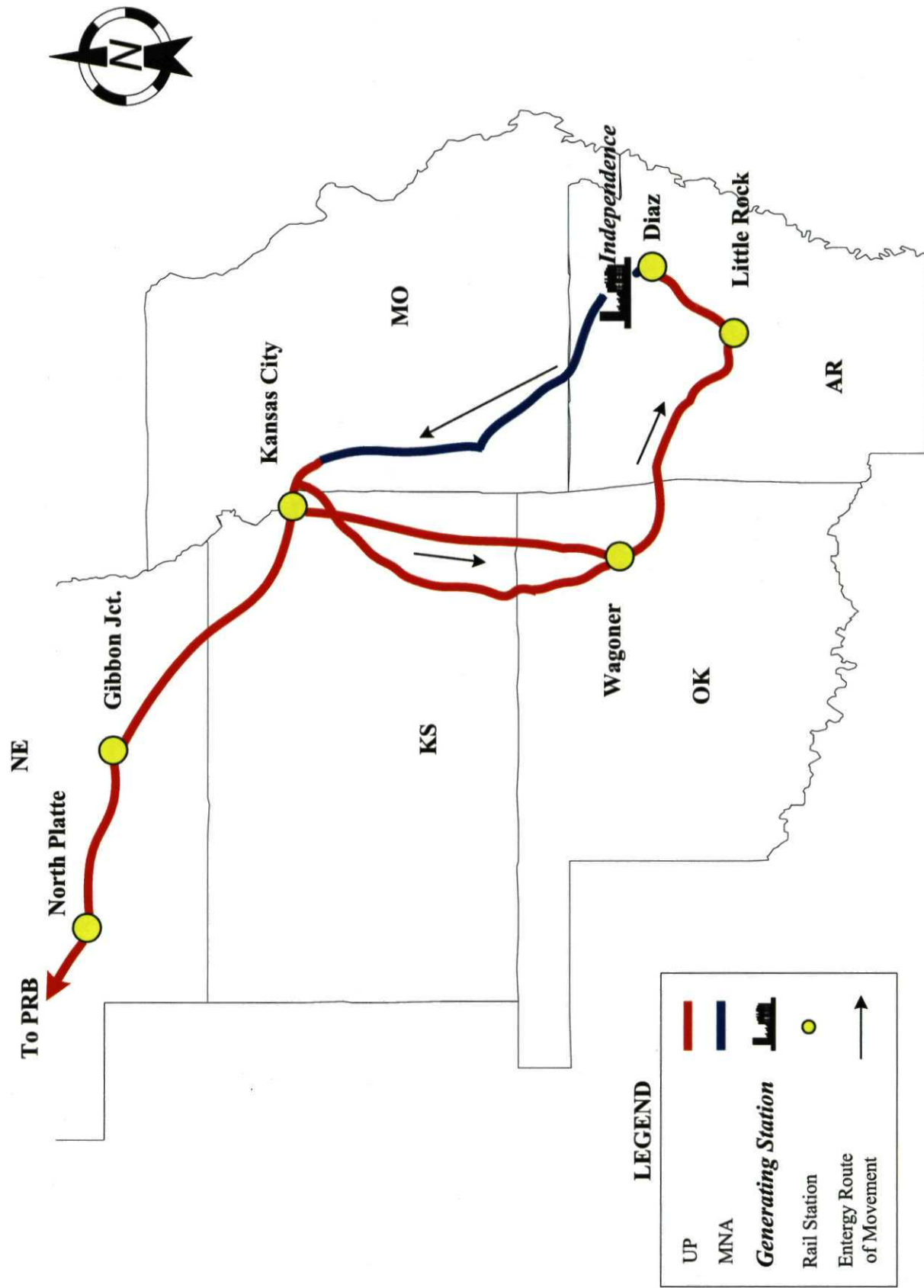
**COUNSEL'S EXHIBIT
NO. 4**

Schematic Of UP's Route From PRB To Entergy's Independence Generating Station (1989 - 1998)



**COUNSEL'S EXHIBIT
NO. 5**

Schematic Of UP's Route From PRB To Entergy's Independence Generating Station **(1998 - Present)**



**COUNSEL'S EXHIBIT
NO. 6**

REDACTED

,

**COUNSEL'S EXHIBIT
NO. 7**

REDACTED

**COUNSEL'S EXHIBIT
NO. 8**

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

ENTERGY ARKANSAS, INC. and	)	
ENTERGY SERVICES, INC., Complainants	)	
v.	)	Docket No. 42104
UNION PACIFIC RAILROAD	)	
COMPANY and MISSOURI &	)	
NORTHERN ARKANSAS RAILROAD	)	
COMPANY, INC., Defendants.	)	
MISSOURI & NORTHERN ARKANSAS	)	
R.R. – LEASE, ACQUISITION AND	)	
OPERATION EXEMPTION – MISSOURI	)	Finance Docket No. 32187
PACIFIC R.R. and BURLINGTON	)	
NORTHERN R.R.	)	

**COMPLAINANTS' FIRST SET OF INTERROGATORIES AND
REQUESTS FOR PRODUCTION OF DOCUMENTS TO DEFENDANT
MISSOURI & NORTHERN ARKANSAS RAILROAD COMPANY**

Complainants Entergy Arkansas, Inc. ("EAI") and Entergy Services, Inc. ("ESI") (collectively, "Entergy") hereby serve this first set of interrogatories and requests for production of documents upon Defendant, Missouri & Northern Arkansas Railroad Company ("M&NA"). Entergy requests that M&NA answer each interrogatory separately, in writing and under oath, and produce responsive documents at the offices of Entergy's counsel within thirty days of the date of these requests (*i.e.*, by April 16, 2008).

Request for Production No. 12:

Please produce any analyses regarding the nature and/or cost of any work that would be necessary to upgrade M&NA's lines to permit M&NA to handle loaded Entergy trains.

Request for Production No. 13:

Please produce copies of all correspondence relating to requests for M&NA service in conjunction with a carrier other than UP.

Request for Production No. 14:

Please produce all internal documents relating to potential M&NA service (whether generated in response to a shipper request or generated for internal purposes) that would involve a carrier other than UP, including but not limited to, studies, reports, or analyses of the rates that would be charged for such service or the costs associated with such service.

Request for Production No. 15:

Please produce all documents identified in M&NA's Answers to Entergy's Interrogatories.

Respectfully submitted,

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ENTERGY SERVICES, INC.

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**COUNSEL'S EXHIBIT
NO. 9**

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Docket No. 42104

**ENTERGY ARKANSAS, INC. AND ENTERGY SERVICES, INC.
v.
UNION PACIFIC RAILROAD COMPANY AND MISSOURI & NORTHERN
ARKANSAS RAILROAD COMPANY, INC.**

Finance Docket No. 32187

**MISSOURI & NORTHERN ARKANSAS RAILROAD COMPANY, INC.
-LEASE, ACQUISITION AND OPERATION EXEMPTION-
MISSOURI PACIFIC RAILROAD COMPANY AND
BURLINGTON NORTHERN RAILROAD COMPANY**

**MISSOURI & NORTHERN ARKANSAS RAILROAD COMPANY, INC.
RESPONSE TO COMPLAINANTS FIRST SET OF INTERROGATORIES AND
REQUESTS FOR PRODUCTION OF DOCUMENTS**

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600 Baltimore Avenue
Suite 301
Towson, MD 21204
(202) 466-6532**

**Attorneys for: MISSOURI & NORTHERN
ARKANSAS RAILROAD COMPANY,
INC.**

Dated: April 16, 2008

BEFORE THE
SURFACE TRANSPORTATION BOARD

Docket No. 42104

ENTERGY ARKANSAS, INC. AND ENTERGY SERVICES, INC.
v.
UNION PACIFIC RAILROAD COMPANY AND MISSOURI & NORTHERN
ARKANSAS RAILROAD COMPANY, INC.

Finance Docket No. 32187

MISSOURI & NORTHERN ARKANSAS RAILROAD COMPANY, INC.
RESPONSE TO COMPLAINANTS' FIRST SET OF INTERROGATORIES AND
REQUESTS FOR PRODUCTION OF DOCUMENTS

Missouri & Northern Arkansas Railroad Company, Inc. ("M&NA") responds to the First Set of Interrogatories and Requests for Production of Documents propounded by Entergy Arkansas, Inc. and Entergy Services, Inc. ("Complainants") served on March 17, 2008 (the "Discovery Request").

GENERAL RESPONSES

The following general responses are made with respect to all of the discovery requests.

1. M&NA has conducted a reasonable search for responsive documents and information to respond consistent with the stated objections.¹

¹ Thus, any response that states that responsive documents are being produced is subject to the General Objections, so that, for example, any documents subject to attorney-client privilege or the work product doctrine are not being produced.

Request for Production No. 12: Please produce any analyses regarding the nature and/or cost of any work that would be necessary to upgrade M&NA's lines to permit M&NA to handle loaded Entergy trains.

Specific Objection: M&NA objects to Request for Production No. 12 on the grounds of relevancy. M&NA further objects to Request for Production No. 12 on the grounds that it is ambiguous in that M&NA is currently handling loaded Entergy trains without additional upgrading and that M&NA does not know what other service Complainants are seeking. M&NA further objects to Request for Production No. 12 on the grounds it would require a special study to consider all of the potential permutations of interchange to serve Complainants without input from Complainants as to the move.

Response: M&NA will not produce documents responsive to Request for Production No. 12.

Request for Production No. 13: Please produce copies of all correspondence relating to requests for M&NA service in conjunction with a carrier other than UP.

Specific Objection: M&NA objects to Request for Production No. 13 on the grounds of relevancy. M&NA further objects to Request for Production No. 13 on the grounds that the burden or expense of the proposed discovery outweighs its likely benefit.

Response: Without waiving the General Objections or Specific Objections, in response to Request for Production No. 13, M&NA is producing documents for 2005, 2006, and 2007.

Request for Production No. 14: Please produce all internal documents relating to potential M&NA service (whether generated in response to a shipper request or generated for internal purposes) that would involve a carrier other than UP, including but not limited to, studies, reports, or analyses of the rates that would be charged for such service or the costs associated with such service.

Specific Objection: M&NA objects to Request for Production No. 14 on the grounds of relevancy. M&NA further objects to Request for Production No. 14 on the grounds that the burden or expense of the proposed discovery outweighs its likely benefit.

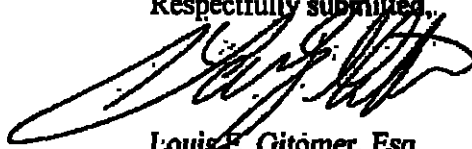
Response: Without waiving the General Objections or Specific Objections, in response to Request for Production No. 14, M&NA is producing documents.

Request for Production No. 15: Please produce all documents identified in M&NA's Answers to Entergy's Interrogatories.

Specific Objection: M&NA objects to Request for Production No. 15 on the grounds of relevancy.

Response: Without waiving the General Objections or Specific Objections, in response to Request for Production No. 14, M&NA is producing documents.

Respectfully submitted,



Scott G. Williams Esq.
Senior Vice President & General Counsel
RailAmerica, Inc
5300 Broken Sound Boulevard N.W.
Second Floor
Boca Raton, FL 33487
(561) 226-1757

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Attorneys for: MISSOURI & NORTHERN
ARKANSAS RAILROAD COMPANY,
INC.

Dated: April 16, 2008

**COUNSEL'S EXHIBIT
NO. 10**

**Before The
U.S. House of Representatives
Committee on Transportation and Infrastructure**

**September 20, 2007 Hearing
11:00 A.M.
2167 Rayburn House Office Building**

**Testimony Of
Commissioner Francis P. Mulvey
Surface Transportation Board
395 E Street, SW, Suite 1290
Washington, DC 20423-0001
(202) 245-0210**

Good afternoon Chairman Oberstar, Ranking Member Mica, and other Committee Members. Thank you for this opportunity to testify on rail competition and service matters.

Following the passage of the Staggers Rail Act of 1980, which greatly reduced economic regulation of the railroad industry, there were many who felt that the Interstate Commerce Commission should be abolished completely and that rail transportation rates and service should be determined by market forces (subject to the anti-trust laws). However, it was clear to most in Congress that the railroad industry did differ in important ways from other industries and that some degree of economic regulation needed to continue to protect the interests of those shippers who were “captive” to the railroads. The Surface Transportation Board was created to balance the needs of shippers for reasonable rates with the need of the railroads to earn adequate revenues. The overall questions we confront today are “how well has the Board met its charge to balance those interests” and “what is the state of competition in the transportation of bulk commodities that are largely captive to the railroads?”

To some extent the answers depend on where you sit, but clearly there are many who believe that the Board could do more to promote competition, ensure reasonable rates for captive shippers, and improve the reliability and quality of railroad services.

In the early years of the Surface Transportation Board, the agency continued to focus on ensuring that the railroads regained their financial health. In addition to decisions that allowed the carriers to capitalize, through differential pricing, on routes where shippers were captive, the Board also approved mergers of large railroads paying less attention to competitive concerns than to the perceived opportunities for the merging carriers.

Pressure from the Congress eventually resulted in the Board's declaring a moratorium on major rail mergers and in the establishment of new merger guidelines that promised to take more account of the competitive impacts of railroad consolidations.

Over the past 3 years, the Board has held a number of hearings on issues related to railroad competition. On October 19, 2005, the Board held a hearing on the state of the railroad industry since the passage of Staggers. The testimony was near unanimous that the industry has largely recovered

from the financial malaise that plagued it during the 1960s and 1970s. The Board also has held hearings and has undertaken a number of initiatives aimed at balancing the scales between shippers and railroads. Let me briefly outline some of the areas where I believe that progress has been made.

First, fuel surcharges. The railroads were calculating fuel surcharges as a percentage of the rates they charged their customers. This meant that captive shippers, who already paid higher rates, had to also pay higher fuel surcharges despite the fact that their shipments did not necessarily require greater fuel usage. The Board found this to be an unfair practice and directed the railroads to compute the surcharges to more closely reflect actual fuel consumption.

Second, access to rate relief. Shippers have long complained that the Board's procedures were too time consuming and too costly. The Board's procedures for adjudicating rate cases (the stand alone cost test) is founded on accepted economic principles and has been approved (if indeed not required) by the courts. The cost of bringing a rate case under the Board's stand alone cost guidelines can cost a shipper several million dollars and the case can take several years to be decided. Even those shippers, who can

justify the expense of bringing a rate case before the Board, generally will either gain no rate relief or a reduction in the proposed rate much below that which they had desired. Shippers whose traffic does not justify the expense of bringing a case under the stand alone cost guidelines believe they have no access to the Board for rate relief.

The Congress more than 20 years ago directed the Board's predecessor, the ICC, to develop simplified, less costly procedures for adjudicating small rate cases. The Board has now acted to address both the cost and timeliness issues in large rate cases, as well as procedures and standards for small rate cases. In October 2006, the STB issued new large rate case guidelines that were designed to take out a significant amount of the time and cost to bring a case under the SAC process. On September 5, 2007, the Board issued new procedures for bringing cases before the Board that do not warrant the expense of a full SAC proceeding. These new rules give shippers the option of selecting how they want to proceed to challenge their rates, but set limits on recovery depending on the process selected. Hopefully, these changes will provide shippers with better access to the Board. I am committed to monitoring the results of these initiatives to see that they work as intended.

In the first test of our new guidelines for large rate cases, the shippers apparently were disadvantaged by the changes. Because of this possibility, the Board has taken the nearly unprecedented step of allowing them to refile their case.

Third, cost of capital. The Board has consistently found that the nation's railroads are "revenue inadequate" despite the fact that Wall Street has found the railroads to be profitable. One of the reasons for this disparity lies in the approach that the Board has taken to determine revenue adequacy. More than 20 years ago, the Board adopted a "Discounted Cash Flow" (DCF) methodology to determine the cost of equity capital. However, over the years, this approach has lost favor with the finance community and the DCF method has long been abandoned by most other agencies that need to make such a calculation. On August 14, 2007, the Board announced a proposed change that could, if adopted, reconcile the Board's estimation of the revenue adequacy of the railroads with that which prevails on Wall Street.

At the same time, there are other areas where the Board has not yet made as definitive a commitment to change. Several areas are of particular concern to me.

Paper Barriers. The Board has been examining the question of what to do about so-called “paper barriers,” otherwise known as interchange commitments. These provisions arise when a Class I railroad sells or leases some of its light density trackage to a small or new short line railroad. Often the short line pays little or nothing for the right to haul the traffic, but it must agree to interchange the traffic only with the Class I that leased or sold it the track. Interchanging with another railroad would result in severe penalties. I find this practice to be anti-competitive and I have dissented from the majority in several cases where paper barriers were contained in the sales or lease agreements.¹ What is particularly troublesome to me is that these restrictions on the short lines’ ability to interchange with other carriers, and thereby offer shippers a competitive option, go on in perpetuity. Just as new entrants have been the source of competition for legacy carriers in the airline industry, so too could these new carriers become the source of competition in the rail industry in the future.

¹ Paducah & Louisville Ry – Acquisition – CSX Transp., Inc., STB Finance Docket No 34738 (STB served Nov. 18, 2005) (Comm’r Mulvey dissenting, at 6-7); Columbus & Ohio River R.R. – Acquisition and Operation Exemption – Rail Lines of CSX Transp., Inc., STB Finance Docket No 34540 (STB served Nov. 18, 2005) (Comm’r Mulvey dissenting, at 9), Indiana & Ohio Centr. R.R. – Acquisition and Operation Exemption – CSX Transp., Inc., STB Finance Docket No 34536 (STB served Aug 23, 2005) (Comm’r Mulvey dissenting, at 9-10), Buckingham Branch R.R. – Lease – CSX Transp., Inc., STB Finance Docket No 34495 (STB served Nov. 5, 2004) (Vice Chr Mulvey dissenting, at 13)

Status of Competition. I am also concerned about the state of competition overall in the railroad industry. The Government Accountability Office has recently reported on the status of competition in the rail industry, and I will not repeat its findings here. I did, however, believe that the study inaccurately claimed that the extent of captivity was declining, implying that there were fewer captive shippers than previously. Even if relative captivity (i.e., the percentage of traffic that is captive) has declined, there is no evidence that competitive options have increased for captive shippers. Although the GAO admits that the approach it took to measuring captivity left much to be desired, I believe that the implications drawn do not comport with reality. The GAO also suggested that the STB undertake a study of competitiveness in the railroad industry. The Board, rightfully I believe, initially declined to follow the GAO's recommendation because we lacked the resources. However, the Board has recently contracted to have a study done in response to GAO's suggestions by a private consulting firm, Christensen Associates. Although this is a well-regarded economic consulting firm, I regret that our resources were not committed to the study authorized in the SAFETEA-LU bill which would have focused more on how well the Board has handled its mission.² The study requested in

² Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU),

SAFETEA-LU would have been undertaken by the Transportation Research Board, an arm of the National Academy of Sciences.

Investment in Railroads. The overall financial condition of the railroad industry has improved dramatically over the past few years, so much so that it has led to increased interest on the part of private equity firms or hedge funds. These types of investors are often into investments to maximize short term gains for their shareholders. What is of most concern to me would be an attempt by a hedge fund to purchase a significant stake in a railroad, followed by divestiture of the railroads' assets, deferred maintenance, and disinvestment in capital improvements. These actions could result in deterioration of service to shippers and then perhaps lead to a failing firm. The Board does not appear to have any authority under existing law to limit such investments.

Without projecting the outcome of any particular proceeding that might come before us, and aside from recent initiatives we have completed or have pending before us, I have several suggestions for improving rail competition and service.

One common theme we do hear from all rail stakeholders – albeit expressed in different ways – is that there needs to be more investment in rail infrastructure. It seems that the railroads alone will not be capable of making the levels of investment needed, given the capital intensity of the industry. If we, as a nation, are serious about shifting traffic from our highways to rails, we need to devote more public money into our rail infrastructure. While the railroads favor an investment tax credit, I personally believe the amounts that will be needed will be far greater than what an ITC would realistically produce. A railroad trust fund of the type recommended by former Representative and T&I Committee member Bill Lipinski, could generate the monies that will be required to upgrade and build our nation's rail transportation infrastructure.

Further, I believe that the Board must adjust the focus of its operations to better reflect changing circumstances. For example, the Board currently exercises regulatory oversight over about a third of all railroad traffic. Most traffic is exempt from our regulation because it is presumed to be competitive with other modes of transportation or because it moves under contract. In the case of the latter, railroad/shipper agreements have evolved

so that the line between contract and tariff carriage has become blurred. The Board is currently examining how and whether it needs to clarify the distinction between the two. With respect to exempt traffic, it is best that traffic for which rates can be determined by the competitive marketplace not be subject to economic regulation. That type of regulation proved disastrous before the transportation industries were largely deregulated. However, times change and as they change so does the competitive landscape. I believe we need to look at existing class exemptions periodically to determine whether exemptions that are premised on the availability of intermodal competition remain warranted. Many of these exemptions were sought and granted in the 1980's when the transportation landscape was quite different than it is today.

Finally, to ensure that the Board has the requisite power to take action on issues of concern to the industry and its stakeholders, the Congress may want to consider returning a general power to investigate to the Board. Currently, under 49 U.S.C 11701, the Board may begin an investigation on a potential violation of the rail portions of its statute "only on complaint". It may be appropriate to revise this language by striking "only" and adding "or on its own initiative." If the Congress wants the Board to continue to

actively seek out problems, and to solve them, guidance in this form would be helpful.

Thank you for the opportunity to testify today. I look forward to answering any questions you may have.

**COUNSEL'S EXHIBIT
NO. 11**

REDACTED

**COUNSEL'S EXHIBIT
NO. 12**

REDACTED

**COUNSEL'S EXHIBIT
NO. 13**

REDACTED

**COUNSEL'S EXHIBIT
NO. 14**

REDACTED

**COUNSEL'S EXHIBIT
NO. 15**

REDACTED

**COUNSEL'S EXHIBIT
NO. 16**



MISSOURI & NORTHERN ARKANSAS RAILROAD

514 N. Ormer • P.O. Box 776 • Carthage, MO • 64836 • Phone: 417.358.8800 • Fax: 417.358.6005

October 6, 2006

Susan Vieregger
Union Pacific Railroad
1400 Douglas; Mail Stop 1350
Omaha, NE 68179

Dear Susan:

Entergy Services, Inc. ("Entergy") has requested a rate quote from the Missouri & Northern Arkansas Railroad Company, Inc. ("MNA") for the movement of coal. Entergy is planning a test burn of 75,000 tons of imported coal in the first quarter of 2007 at its Independence plant near Newark, AR. The rate quote from MNA would be for part of the movement of coal from the IC Rail Marine Terminal at Convent, LA to MNA via the Canadian National Railway Company and the Kansas City Southern Railway Company.

Pursuant to Section 23.08 of the Lease Agreement dated as of December 11, 1992 (the "Lease") between the Missouri Pacific Railroad Company ("UP") and MNA, as amended, MNA requests UP to waive the provisions of Section 4 of the Lease, as amended. MNA proposes to exclude the 75,000 tons of coal that Entergy seeks to use for the test burn (the "Test Burn Coal") from the calculation of the amount of traffic originating or terminating on the Leased Premises so by moving the Test Burn Coal, MNA will not exceed volumes specified in section 4.03 of the Lease, as amended. By this letter, MNA is seeking only a waiver for the movement of the Test Burn Coal.

If UP is agreeable to this waiver, MNA will provide an appropriate supplemental agreement for UP to review. Please notify MNA of UP's decision within two weeks of the date of this letter.

Thank you for your assistance.

Sincerely yours,

Anita Horton
Manager - Marketing and Sales

Copy to

~~Sandy Houghton, RA/Boca~~
Chris Cornett, MNA
Tom Owen, RA/Boca
Daniel Hershman, RA/Boca

Scott Hulstrom, RA/Central
Scott Williams, RA/Boca
Peter Valade, RA/Boca
Lou Gitomer

(Hard copy to follow via mail)



A RailAmerica Company

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**COUNSEL'S EXHIBIT
NO. 17**

Folder 66 MNA

MNA-Entergy Rate Remarks
via KCS - 2006



MISSOURI & NORTHERN ARKANSAS RAILROAD

514 N. Ormer • P.O. Box 776 • Cardigan, MO • 64836 • Phone: 417.358.8800 • Fax: 417.358.6005

October 13, 2006

Mr. Dan Gray
Entergy Services, Inc.
10055 Grogans Mill Road, Suite 5B
The Woodlands, TX 77380

Re: Rate Quote

Dear Mr. Gray:

Thank you for your response of October 6, 2006 to my letter of October 6, 2006. There are two points that need clarification.

First, without receiving the specific operational information that was requested in the October 6, 2006 letter, the Missouri & Northern Arkansas Railway Company, Inc. ("MNA") cannot quote a rate to Entergy Services, Inc. ("Entergy") for the move of 75,000 tons of import coal in the first quarter of 2007 from the IC Rail Marine Terminal at Convent, LA, to Entergy's Independence plant near Newark, AR, via Canadian National Railway Company ("CN") and The Kansas City Southern Railway Company ("KCS").

Second, MNA will exercise its rate and route discretion and will quote a rate as part of a joint line rate with CN and KCS. MNA does not participate in the ISS settlement system. Therefore, MNA is not set up to quote single factor rates or to accommodate the invoicing, collection and settlement necessary to implement single factor rates.

In addition, please advise MNA of the status of Entergy's request to CN and KCS for a rate quote.

MNA looks forward to receiving Entergy's response to the specific information requested in the October 6, 2006 letter that is required to quote the rate that Entergy has requested.

Thank you for your assistance. If you have any questions, please contact me.

Sincerely yours,

Anita Horton

Anita Horton
Manager Marketing & Sales
Missouri & Northern Arkansas Railroad

Copy to ~~Stacy Boush~~
Chris Cornett, MNA
Tom Owen, RA/Boca
Daniel Hershman, RA/Boca

Scott Hulstrom, RA/Central
Scott Williams, RA/Boca
Peter Valade, RA/Boca
Lou Gitomer

(Hard copy to follow via mail)

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**COUNSEL'S EXHIBIT
NO. 18**

F. JAMES SENECHERRER, JR., Wisconsin
CHAIRMAN

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ONE HUNDRED EIGHTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON THE JUDICIARY

2138 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515-6216

(202) 225-3951

<http://www.house.gov/judiciary>

July 15, 2004

JOHN CONYERS, JR., Michigan
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LINDA T. SANCHEZ, California

The Honorable R. Hewitt Pate
Assistant Attorney General
Antitrust Division
Department of Justice
950 Pennsylvania Ave., NW
Washington, DC 20530

Dear Assistant Attorney General:

I write to request that the Department of Justice Antitrust Division provide the Committee with its assessment and views on issues involving the application of the antitrust laws in the railroad transportation industry, and, more generally, on railroad competition policy.

United States railroads currently enjoy limited antitrust immunity. It is not clear that this immunity from antitrust actions serves the public interest in this marketplace. Some of these antitrust exemptions were established over eight decades ago, when competitive conditions in this marketplace were fundamentally different.

For example:

- Railroads are generally exempt from Sherman Act antitrust actions for treble damages if common carrier rates "approved by the [government]" are involved. This exemption is based upon notions of inherent conflict between a pervasive regime of rate regulation and published rates – a regime which no longer exists in the largely deregulated environment in which railroads presently operate. See Keogh v. Chicago & Northwestern R. Co., 260 U.S. 156 (1922); Square D Co. v. Niagara Frontier Tariff Bureau, Inc., 476 U.S. 409 (1986).
- Railroads are generally exempt from private antitrust actions "for injunctive relief against any common carrier subject to the jurisdiction of the Surface Transportation Board under subtitle IV of Title 49." See 15 U.S.C. § 26 et. seq.

The Honorable R. Hewitt Pate

July 15, 2004

Page 2

- Persons participating in approved or exempted railroad consolidation, merger, and acquisition of control are "exempt from the antitrust laws and from all other law, including State and municipal law, as necessary to let that rail carrier, corporation, or person carry out the transaction . . .". See 49 U.S.C. § 11321(a).

To the extent that exemptions from the antitrust laws unfairly shield competitors from competition, these exemptions require scrutiny and reconsideration as conditions warrant. This scrutiny is especially justified given the highly concentrated nature of the railroad industry. After years of industry consolidation, only two major carriers in the West and two major carriers in the East remain in this marketplace. In addition, many individuals, communities, and regions are served by only one railroad carrier.

Additionally, railroad customers have raised a number of concerns toward a range of industry practices that have allegedly suppressed competition in this marketplace. These practices include refusals by railroads to establish common carrier rates on individual "bottleneck" rail segments and corresponding demands that service be provided only on full-through rail routes. This practice produces anticompetitive harm by preventing customers from enjoying the benefits of carrier competition on rail segments in which at least two carriers compete. Another troubling allegation concerns Class I railroads imposing "paper barriers" after spinning off lower density lines to short-line railroads and subsequently preventing these carriers from handling business in conjunction with other railroads that would otherwise be eligible to provide competitive service. Additionally, concerns have been expressed that both of the major western Class I railroads are now attempting to publicly price major portions of their bulk commodity services in a manner that could raise anticompetitive concerns.

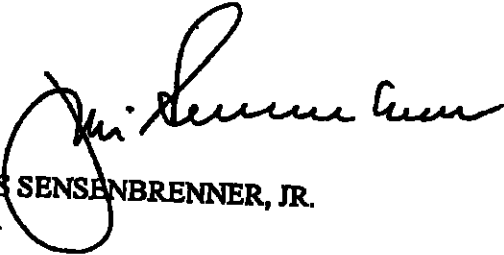
I relay these concerns, not because I seek to substantiate them as indicators of anticompetitive conduct in this marketplace, but rather, because they indicate that additional investigation into industry competitive practices may be warranted. Additionally, these concerns may highlight the need to revisit existing law and regulatory policies to more forcefully promote effective intramodal competition in the transportation marketplace. They may also indicate that investigation by the Department of Justice into such practices may be appropriate.

Given the special expertise of the Antitrust Division and its authority to investigate issues of competitive conduct in the railroad transportation industry, the Committee would benefit from receiving the written views of the Division on this matter.

The Honorable R. Hewitt Pate
July 15, 2004
Page 3

I thus request an assessment of those concerns raised above. I appreciate your willingness to provide the Committee with this information, and request that you respond to this request no later than August 27, 2004.

Sincerely,

A handwritten signature in cursive script, appearing to read "F. James Sensenbrenner, Jr.", written in dark ink. The signature is fluid and somewhat stylized, with a large loop at the beginning.

F. JAMES SENSENBRENNER, JR.
Chairman

FJS/Jud.



Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

September 27, 2004

The Honorable F. James Sensenbrenner, Jr.
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Sensenbrenner:

This responds to your letter of July 15, 2004, to the Department of Justice regarding the application of the antitrust laws in the railroad industry. You note that the various statutory antitrust exemptions for railroad industry activities were enacted many decades ago, and you question whether continuing this antitrust immunity serves the public interest. The Department appreciates having the benefit of your perspective on this important issue of competition policy.

The antitrust laws are the chief legal protector of the free-market principles on which the American economy is based. Experience has shown that competition among businesses, each attempting to be successful in selling its products and services, leads to better-quality products and services, lower prices, and higher levels of innovation. The antitrust laws ensure that businesses will not stifle this competition to the detriment of consumers. Accordingly, the Department has historically opposed efforts to create sector-specific exemptions to the antitrust laws. The Department believes such exemptions can be justified only in rare instances, when the fundamental free-market values underlying the antitrust laws are compellingly outweighed by a clearly paramount and clearly incompatible public policy objective.

In the first decades of the past century, for example, Congress enacted antitrust exemptions in industries in which it believed normal free-market competition to be unworkable. These industries included the railroad, airline, trucking, and telephone industries. In lieu of competition protected by the antitrust laws, Congress established comprehensive regulatory regimes that regulated prices, service offerings, and market entry as well as other aspects of those industries. These regulatory regimes often included statutory antitrust exemptions for conduct approved by the regulatory agency. And if the regulatory regime was sufficiently pervasive, the courts could hold that it had implicitly displaced private damages recovery under the antitrust laws. See *Keogh v. Chicago Northwestern Railway*, 260 U.S. 156 (1922); *Square D Co. v. Niagara Frontier Tariff Bureau*, 476 U.S. 409 (1986).

In the last decades of the past century, policymakers began to reconsider whether competition was truly unworkable in these industries, and efforts were undertaken to replace

The Honorable F. James Sensenbrenner, Jr.
Page 2

market regulation with competition where possible. As those industries became deregulated, antitrust exemptions no longer made sense. In the case of airlines, for example, the antitrust exemption for mergers approved by the Civil Aeronautics Board was repealed and, after a transition period, merger enforcement in the airline industry reverted to the Department of Justice under the antitrust laws.

In 1995, when Congress abolished the Interstate Commerce Commission and created the Surface Transportation Board to retain some of the ICC's old regulatory authority, the Department urged Congress to turn over review of railroad mergers to the antitrust enforcement agencies, as it had done with airlines. See Statement of Steven C. Sunshine, Deputy Assistant Attorney General, Antitrust Division, Before the House Transportation Subcommittee on Railroads, January 26, 1995 (attached). Congress opted instead to leave that responsibility with the Surface Transportation Board, with an accompanying antitrust exemption, with the Justice Department limited to an advisory role before the Surface Transportation Board. See 49 U.S.C. § 11321(a).

Your letter also describes three specific practices in the railroad industry about which concerns have been raised about possible anticompetitive effects.

The first practice is the refusal by a railroad that controls one segment of a freight movement to quote rates separately for that "bottleneck" segment, instead quoting rates only for the entire freight movement. You note that this practice denies shippers the benefits of competition on segments of the move where an alternative carrier might compete for the business. Because of the Surface Transportation Board's involvement in approving these rates, and its acceptance of this practice, relief may not be available under the antitrust laws. If this practice were subject to the antitrust laws, it could be evaluated as a refusal to deal in possible violation of section 2 of the Sherman Act, or as a tying arrangement in possible violation of section 1 of the Sherman Act. Whether it would constitute an antitrust violation would depend on the particular facts.

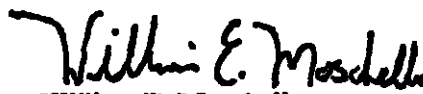
The second industry practice you describe is "paper barriers." Paper barriers are created when Class I railroads spin off segments of their trackage to short-line or low-density carriers with contractual terms that prohibit the acquiring carriers from competing with the Class I railroads for business. Since these contractual terms are part of an underlying sale transaction that is reviewed and approved by the Surface Transportation Board, they may be exempted from the reach of the antitrust laws, depending on the scope of the approval language in each of the Board's relevant orders. If paper barriers were subject to the antitrust laws, they would be evaluated under section 1 of the Sherman Act. The Department would examine whether the restraint is ancillary to the sale of the trackage — i.e., whether the restraint is reasonably necessary to achieve the pro-competitive benefits of the sale.

The Honorable F. James Sensenbrenner, Jr. .
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The third industry practice you describe is the practice by both of the major western Class I railroads of publicly disclosing tentative prospective shipping rate offerings. Under the antitrust laws, the public disclosure of pricing information among competitors can, under some circumstances, facilitate collusion and result in increased prices, in violation of section 1 of the Sherman Act. See, e.g., *United States v. Airline Tariff Publishing Co.*, 1994 Trade Cas. (CCH) ¶ 70,687 (D.D.C. 1994). Publicly announcing prospective rates outside the confines of a rate approval proceeding at the Surface Transportation Board is likely to be subject to review under the antitrust laws. If you know of anyone who has information that you believe might be useful for evaluating this practice under the antitrust laws, please encourage them to contact the Antitrust Division.

Thank you for bringing your interest in these issues to our attention, and for soliciting our views as you consider these issues. If we can be of further assistance, please do not hesitate to contact us.

Sincerely,


William E. Moschella
Assistant Attorney General

Enclosure



DEPARTMENT OF JUSTICE

STATEMENT OF

STEVEN C. SUNSHINE
DEPUTY ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION
UNITED STATES DEPARTMENT OF JUSTICE.

BEFORE THE
SUBCOMMITTEE ON RAILROADS
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
HOUSE OF REPRESENTATIVES

CONCERNING COMPETITIVE REVIEW OF RAILROAD
MERGERS AFTER ICC SUNSET
ON
JANUARY 26, 1995

Madam Chairwoman and Members of the Subcommittee: I very much appreciate this opportunity to appear before you today to explain how the Department of Justice would review railroad mergers and acquisitions if the Interstate Commerce Commission's authority to review and approve those transactions is repealed. The Department of Justice believes that railroad mergers and acquisitions should be reviewed under the same legal standards that apply to virtually every other sector of our nation's economy. We believe that the antitrust approach would provide significant advantages, saving time and scarce federal resources and reducing burden and delay on the merging parties, while still protecting the public interest by preventing anticompetitive mergers.

For most of our economy, Congress has chosen to rely on market competition rather than government regulation to protect consumers and the public interest. Not only does competition best allocate scarce goods and services to those who value them most highly, it also forces firms to become as efficient as possible. Consumers benefit where competition is vibrant -- it provides the highest possible quality of goods and services at the lowest possible cost. The antitrust laws protect competition by prohibiting unreasonable restraints of trade, including mergers that threaten substantially to lessen competition.

A number of important industries have in recent years been largely freed from economic regulation, including trucking, airlines, and natural gas production. Building on earlier regulatory and legislative efforts, the

Staggers Rail Act of 1980 substantially deregulated the freight rail industry by placing more reliance on market forces. The Staggers Act is widely credited with revitalizing freight railroads, many of which were in precarious financial condition. The next logical step to deregulate further the rail industry would be to eliminate prior government review and approval of mergers under the "public interest" standard that is currently embodied in the Interstate Commerce Act.

Under the Interstate Commerce Act (ICA), rail carrier mergers must receive prior government approval under a broad "public interest" standard before they are permitted to occur. If a merger transaction involves two class I railroads, the ICC may not approve it unless and until the Commission determines that the transaction is, on balance, "consistent with the public interest."⁽¹⁾

The ICA directs the Commission to consider competition, but only as one of five factors to balance in assessing the public interest: the effect of the proposed transaction on the adequacy of transportation to the public; the effect on the public interest of including, or failing to include, other rail carriers in the proposed transaction; the total fixed charges that would result from the proposed transaction; the interest of carrier employees affected by the proposed transaction; and whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region.⁽²⁾

The ICA contemplates intervention in the process by competitors and other interested parties, and provides for lengthy time periods for the Commission to conduct evidentiary hearings and issue its determinations. It can take the Commission up to two to three years to render its decisions on mergers having significant competition issues. Even a rail merger that raises few competitive concerns can be under review at the ICC for a year or more. For example, the ICC recently completed its review of the proposal by the Union Pacific for authority to take control of the Chicago & North Western. Union Pacific filed its application on January 29, 1993; the ICC approved the transaction in December 1994. There was extensive participation by competitors -- competitors who were perhaps more concerned with their own private interests than with the merger's likely impact on rail customers.

A more dramatic example of the time that ICC proceedings can take was the Santa Fe's proposal to take control of the Southern Pacific, which the Department opposed at the Commission. Those railroads first notified the ICC about their proposed combination on November 22, 1983. The ICC's ultimate decision, which disapproved the transaction, was not made until almost 3 years later, on October 10, 1986. Then, close to 2 more years passed before the ICC ordered Santa Fe to divest the Southern Pacific stock, which the ICC had allowed Santa Fe to hold in a voting trust.

The ICA's public interest standard as applied in ICC railroad merger

proceedings has led to the negotiation of many protective and other conditions that caused the merged carrier to make concessions to protesting parties, which often include its principal competitors. Such conditions can limit the potential efficiencies of a merger and protect competitors from the enhanced competition that could otherwise result from a procompetitive combination.

In contrast, merger enforcement under the antitrust laws protects competition, not competitors. Section 7 of the Clayton Act, 15 U.S.C. 18, the primary provision of the antitrust laws governing mergers and acquisitions, prohibits those transactions that threaten "substantially to lessen competition in any line of commerce in any section of the country." The central issue under the Clayton Act is whether the merger will result in increased prices to consumers or reduced services.

Merger decisions are made far more quickly under the antitrust laws than under the ICA. Under the premerger notification provisions of the Hart-Scott-Rodino ("HSR") Act,⁽³⁾ routine mergers that raise no antitrust issues can be consummated upon the expiration of a 30-day waiting period (15 days for cash tender offers). When requested, the antitrust enforcement agencies will in appropriate cases agree to "early termination" of the waiting period in less than 30 days.

Where a merger does raise antitrust concerns, we are able to obtain all of the information we need to resolve those concerns expeditiously. If we need additional information from the parties to complete our investigation, we can issue a "second request" that will extend the waiting period an additional 20 days after the parties supply the requested information.⁽⁴⁾ The Department seeks information from competitors, suppliers, customers, employees, and other knowledgeable parties in order to analyze the effects of the merger. In addition, we can seek documents, deposition testimony, and interrogatory answers from the parties and other persons pursuant to the Antitrust Civil Process Act.

When the Department determines that a proposed merger raises significant competitive issues, several steps are available to speed resolution of the matter. Most such matters are resolved in 6 months to a year. The parties can "fix-it-first" by restructuring the transaction, which avoids a legal challenge by the Department. If the investigation runs its course and the Department decides to challenge the transaction, the parties and the Department frequently negotiate a consent judgment that corrects the competitive problem but otherwise allows the remainder of the transaction to go forward.

If the Department concludes that a merger transaction as structured would violate the antitrust laws, and the parties do not wish to restructure it, the Department must go to court to prevent the transaction. The Department can seek a preliminary injunction, which prohibits the merger pending a full trial for a permanent injunction. Even if the case goes through a full trial, it

will likely be resolved less than a year after the complaint is filed, substantially less time than it usually takes the ICC to reach a final decision on a merger under the ICA. However, only a small percentage of the mergers reviewed by the Department are challenged in court.

The analytical framework we use in merger investigations is set forth in the 1992 Horizontal Merger Guidelines, issued jointly by the Department of Justice and the Federal Trade Commission. These Merger Guidelines have been cited and relied on by the courts in merger cases. Under the Merger Guidelines, we assess the merger's likely harm to competition, and consider any efficiencies that may outweigh potential harmful effects.

Our competitive analysis takes into account the position of each of the merging firms in each economically meaningful "relevant market", the relevant market's concentration, the extent to which that concentration would be increased, the competitive conditions likely to exist in the market after the transaction, and the likely ability of the resulting firm to raise prices or lower services to the detriment of consumers. We define relevant markets carefully, through an evaluation of any effective substitutes customers have for the services provided by the merging firms.

For railroad mergers, the analysis begins with identification of the affected routes. For two railroads with largely parallel routes, the logical starting point for defining a market is the carriage of a particular commodity from one point (called an origin) to a second point (called a destination) by the merging railroads.

Once the affected routes are identified, the analysis generally focuses on an evaluation of the other rail, intermodal, product, and source competition options available to shippers. Intermodal competition is the ability of a shipper to substitute another mode of transportation, usually truck or water carriage, for the shipment of a particular commodity between a particular origin and destination. If truck or water service is available and is a close substitute for rail carriage for certain commodities, these competitive alternatives would prevent a rail carrier from raising its rates for these commodities. For other commodities, however, trucks may be at a significant disadvantage to rail where, for example, the distance the commodity is shipped is great, the volume of the commodity shipped is large, or the value of the commodity as compared to its weight is small.

Other forms of competition considered include product and source competition. "Product competition" is the ability of a shipper to substitute another commodity that allows use of a transportation system other than the merged rail carrier. "Source competition" is the ability of shippers in the region of the merging railroads to avoid high rail rates by shipping a commodity to another destination or by obtaining it from another source, again using other than the merged rail carrier.

If one or more of these forms of competition is available, its existence will be reflected in the Department's definition of the markets affected by the

merger. If such competition is significant, it may defeat or limit the ability of the merged carrier to raise prices. The degree to which any of these methods of competition will be effective will vary according to the nature of the commodities, routes, and perhaps other factors, including differences in demand and/or supply elasticity for different commodities.

The antitrust laws do not prohibit efficient railroad mergers that can benefit shippers. The Merger Guidelines expressly recognize that mergers can enhance efficiency. When necessary to an evaluation of the net competitive effects of a merger, we consider the prospect that real efficiencies will be achieved that could not be realized absent the merger. Thus, the Department of Justice will challenge a merger only when its likely harm to competition is not outweighed by its likely efficiencies.

The Department has not opposed rail mergers that did not significantly threaten competition. Over the past 10 years, the Department opposed only one rail merger in its entirety — the proposed consolidation of the Santa Fe and Southern Pacific Railroads — a transaction the ICC ultimately disapproved. The Department raised no objection to the two rail mergers most recently approved by the ICC: Kansas City Southern's acquisition of Mid-South, and the Union Pacific's control of the Chicago & North Western.

In sum, our analysis of proposed railroad mergers using the Merger Guidelines is the same general analysis we use in reviewing mergers subject to the antitrust laws. That analysis is sophisticated, thorough, and flexible — it involves far more than simply computing market shares or concentration figures. It takes into account all the dynamics of the markets with which we are dealing.

Subjecting railroad mergers and acquisitions to the antitrust laws would expedite both the investigation and resolution of such transactions.

Madam Chairwoman, this concludes my prepared remarks. I would be happy to respond to any questions that you or other members of the Subcommittee may have.

FOOTNOTES:

1. 49 U.S.C. 11344(c). If a merger transaction does not involve two class I railroads, the ICA requires approval unless the ICC finds there is likely to be substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States and the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs. *Id.* 11344(d).

2. 49 U.S.C. 11344(b)(1).

3. 15 U.S.C. 18a.

**COUNSEL'S EXHIBIT
NO. 19**

REDACTED