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Robert T Opal
General Commerce and FRA Counsel

August 21, 2008

Via E-Filing

The Honorable Anne Quinlan
Acting Secretary
Surface Transportation Board
395 E Street, SW
Washington, D.C. 20423

**Re: Ex Parte No. 677 (Sub-No. 1) Common Carrier Obligation of
Railroads – Transportation of Hazardous Materials**

Dear Secretary Quinlan,

Enclosed for filing in the public docket is the REDACTED of the Verified Statement of Warren B. Beach, Union Pacific's Assistant Vice President for Finance and Insurance. This statement responds to questions which Board members raised at the July 22, 2008 hearing related to railroad insurance

We have submitted under separate cover a HIGHLY CONFIDENTIAL version of Mr Beach's statement

Very truly yours,

Robert T. Opal
Robert T Opal *GSM*

Att

REDACTED - TO BE PLACED ON PUBLIC FILE

VERIFIED STATEMENT OF WARREN B. BEACH

My name is Warren B. Beach. I am Assistant Vice President for Finance and Insurance for Union Pacific Railroad Company (UP) and Assistant Treasurer of Union Pacific Corporation, UP's holding company. My business address is 1400 Douglas Street, STOP 1920, Omaha, Nebraska, 68179-1920. I have been employed by Union Pacific since July, 1986 and have held my present position since February, 2001. I am responsible for all of UP's non-benefit related insurance programs, including liability and property. I am providing this statement in response to requests by Board members at the July 22 hearing in Ex Parte No. 677 (Sub-No. 1) for additional information on railroad liability insurance and toxic by inhalation (TIH) chemicals.

First of all, some background on railroad liability insurance may be useful. UP purchases all of its liability insurance from Wasatch Insurance, a wholly owned, Bermuda-domiciled captive insurer. A captive insurer is a legally recognized insurance company whose sole purpose is to provide insurance to its parent corporation (UP, in this case). For the record, there is no tax advantage to UP to use a captive. We have taken the election offered in Section 953d of the Internal Revenue Code to have our offshore captive taxed as a domestic US corporation.

The reason we use a foreign, captive insurer is that it provides access to *global reinsurance markets*. Most of the big U.S. domestic insurance companies are focused on business lines such as life, homeowners, auto, and small to midsize business insurance. They have no interest in Class I railroads and will not insure them. So we have to look outside the U.S. at the largely unregulated reinsurance markets.

Reinsurers are companies that insure insurance companies. Insurance companies need to spread the risks of big events like major hurricanes in Florida. One way they do that is by purchasing reinsurance.. insurance for insurance companies... to help them pay claims when a really big loss happens. Having our own "captive" insurance company gives us access to the global reinsurance market. Wasatch insures Union Pacific. Reinsurers insure Wasatch. Wasatch is the conduit between UP and the reinsurance market.

Most of the big reinsurance companies are located overseas, and the global reinsurance market for U.S. railroads is relatively small. I do not know of *any reinsurance markets in Asia, the Mid East, Africa, Australia or South America* that are interested in North American Class I railroads. With one notable exception, North American (U.S. & Canada) carriers are not interested in the U.S. rail market. That leaves Western Europe (primarily England, Ireland, France, Germany, Switzerland) and Bermuda.

Reinsurance companies provide a hierarchy of coverage - that is, no one company provides UP's total coverage. A typical reinsurer will issue one policy from about \$50 million to \$100 million. In today's market a buyer must purchase 10 to 20 individual policies (from 10 to 20 different reinsurance companies) in order to have an aggregate of \$1 billion of coverage. The policies are arranged in a very strict hierarchy that defines the order in which each policy will respond to a loss. The first policy (the policy most at risk) costs significantly more than the last policy (or the policy least at risk).

\$100 million dollars is a lot of money. It is a huge financial commitment, even for a large global reinsurance company. The process of purchasing even a single \$100 million dollar policy requires intense, personal, executive-level negotiations on both sides of the table. Both sides come equipped with reports from actuaries, attorneys, brokers, adjusters, underwriters, and more. No insurance executive makes a commitment of this size without a great deal of thought.

UP is self insured to \$25 million. In other words, UP's commercial liability insurance does not cover losses of \$25 million or less, and does not cover the first \$25 million of a loss that exceeds this amount. Our self insured retention has more than doubled in recent years because of industry losses

Beyond this, UP currently (2008) has commercial liability insurance totaling \$1 billion. This represents the total coverage offered by a hierarchy of reinsurance policies purchased from 17 different reinsurers. The individual policies range in size from \$2.5 million to \$150 million. One third of the dollar coverage was provided by six very large reinsurers in Europe. Two thirds of the dollar coverage was provided by 10 reinsurers in Bermuda. There is only one U.S. reinsurer on our account.

The cost of these policies for 2008 was \$ million. This represents an increase on a compound annual basis of 18% per year from the amount we paid for similar coverage in 2000 (\$ million). I understand the Board members were also interested in the amount of premiums paid for TIH incident coverage as compared to coverage for other incidents. Our policies do not separately break out TIH incident coverage (or the premiums for that coverage), so it is not possible to give a definite number.

Based on my many years of experience dealing with railroad insurance, the \$1 billion in commercial insurance coverage we obtained for 2008 was about the maximum coverage available to us in the market.¹ We consider \$1 billion to be insufficient to cover our potential exposure, particularly for TIH incidents.

¹ Insurance markets are subject to short term fluctuations, so the maximum coverage available on any given date may be slightly higher or lower than this amount.

In the past, there were other domestic and international reinsurers who were willing to participate in railroad insurance, and the potential limits were as high as \$1.5 billion. That, however, is no longer the case. Many insurance and reinsurance companies have been adversely affected in recent years. Terrorism, global recession, the sub-prime mortgage debacle, and catastrophic claims from natural disasters have all contributed to shrinking markets. In addition, hazardous material releases in Graniteville, South Carolina, Minot, North Dakota, and Eunice, Louisiana, together with terrorist bombings of passenger rail facilities in London and Madrid, have all driven insurers and reinsurers from the rail liability market. If there are additional large claims, my prediction is that the reinsurance market will contract even more, further reducing capacity and increasing costs for obtaining the insurance that is available. In fact, we are concerned that the market may shrink next year due to the Graniteville claims

The issue this presents for UP is that a T1H incident has the potential to cost many billions of dollars, and there is no insurance available that provides coverage commensurate with the risk. To give an idea of the exposure we could be facing, in 2006, the American Academy of Actuaries (AAA) prepared estimates of the costs of various terrorism scenarios for the President's Working Group on Financial Markets. AAA estimated that the losses from a chemical, nuclear or biological release (CNBR) in an urban area could range up to \$42.3 billion for an incident in Des Moines, and up to \$778.1 billion for incident an in

New York City.² Obviously, our insurance does not even come close to covering losses of these magnitudes.

This situation is analogous to rail transportation of spent nuclear fuel, another commodity which, if involved in a major release, could result in damages that far exceed available commercial insurance capacity. The difference is that Congress established the Price-Anderson Act as a way of mitigating the huge risks involved in the use and handling of nuclear materials. As a result, UP does not face "bet the company" exposure whenever it transports a load of spent nuclear fuel.

In summary:

1. The worldwide reinsurance capacity available to UP is limited to about \$1 billion, which is the amount UP currently carries.
2. The cost of the available capacity is increasing and deductibles are rising.
3. A major TIH incident could easily result in liability exposure far exceeding \$1 billion.
4. We cannot purchase insurance that is commensurate with the risk inherent in transporting TIH.

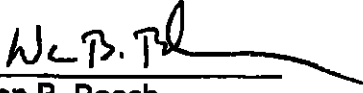
This is not a sustainable business model for UP.

² American Academy of Actuaries Comments to President's Working Group on Financial Markets, April 21, 2006, Appendix II.

DECLARATION

I declare under penalty of perjury that the foregoing statement is true and correct to the best of my knowledge, belief and information.

Executed on August 21, 2008.



Warren B. Beach