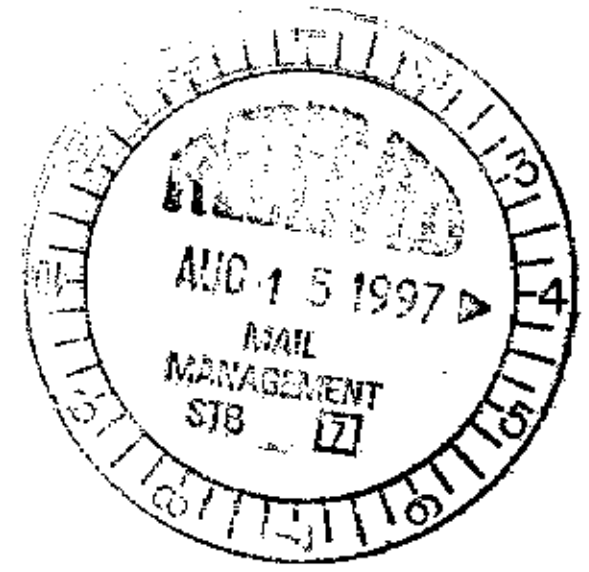


BEFORE THE
SURFACE TRANSPORTATION BOARD



STB FINANCE DOCKET NO. 32760 (SUB-No. 21)

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 [OVERSIGHT]

COMMENTS OF THE
UNITED STATES DEPARTMENT OF AGRICULTURE

Lon Hatamiya
Administrator

Agricultural Marketing Service

U.S. Department of Agriculture
Washington, D.C. 20250

Due: August 15, 1997

These comments are filed on behalf of the United States Department of Agriculture (USDA) and are in response to the Surface Transportation Board's (STB) decision served May 7, 1997, initiating a proceeding to implement the oversight condition it imposed in approving the Union Pacific and Southern Pacific Railroad (UPSP) merger of 1996. STB is seeking comments from interested parties on the effects of the merger on competition and as to the implementation of the conditions imposed by the STB to address actual or potential competitive harms.

AUTHORITY AND INTEREST

The Secretary of Agriculture is charged with the responsibility under the Agricultural Adjustment Act of 1938 (7 U.S.C. 1291) and the Agricultural Marketing Act of 1946 (7 U.S.C. 1622 (j)), as amended, to represent the interest of agricultural shippers and producers in improving transportation services and facilities, by among other things, initiating and participating in STB proceedings involving rates, charges, tariffs, practices, and services.

As an active participant in the UPSP merger proceeding, USDA submitted comments to STB on March 29, April 29, and June 3, 1996. In those comments we pointed out that rail service is critical to the economic well-being of this Nation's agricultural and rural economies. Many agricultural products are produced in areas located great distances from export and domestic markets. Moreover, agricultural shippers generally have limited access to alternative providers of transportation services because many are located beyond effective trucking distances from these markets and far from available waterway transportation. We highlighted the importance of competitive rail service for agricultural producers and shippers and the entire rural economy and expressed concern over the significantly increasing concentration in the U.S. rail

industry and the adverse effects on U.S. agriculture of this continuing consolidation and concentration. Our concern was based on the decline in the number of major U.S. railroads from 33 in the early 1980's to just 7 more recently, and the greatly increased overall levels of concentration in the railroad industry which has resulted. Whereas the top 5 railroads handled 44 percent of all railroad freight in 1982, the top 5 railroads handled 87 percent of all rail freight in 1995. Although the top 5 railroads originated 57 percent of all rail grain traffic in 1982, the top 5 railroads originated over 90 percent of rail grain traffic in 1995.

USDA LISTENING SESSIONS ON IMPACTS OF RAIL MERGERS

In a letter dated July 16, 1997, USDA notified the STB of a planned series of listening sessions to be held in major grain-producing states as part of our efforts to gather and evaluate information on the general impact of recent railroad mergers on agricultural shippers and communities and on the specific impact of the UPSP merger. Because the grain harvest in many states had just been completed or was still underway, USDA requested and was granted a two-week extension of time by the STB to evaluate the input presented at the sessions and to submit comments in this proceeding. On August 6 and 7, listening sessions were held by the USDA in Dodge City, Kansas and Wichita, Kansas, respectively. Listening sessions on the general impact of rail mergers on agricultural shippers are planned for other grain-producing states.

USDA believes input from actual shippers who have been affected by the UPSP merger, such as was obtained from these Kansas listening sessions, is vital to the STB oversight process. A national announcement of the holding of the listening sessions resulted in substantial other comment and input being provided to the USDA on effects of the UPSP merger from shippers,

local and state officials, farmers and rural residents from several other grain-producing States. Comments received at the listening sessions or submitted directly to the USDA as a result of the listening sessions were incorporated into this statement.

RAIL COMPETITION IN THE LOWER PLAINS

Initial Concerns

The USDA expressed concern about the UPSP merger, in part, because of our belief that a third major railroad operating in the Kansas City, Wichita and Fort Worth corridor to Gulf and Mexican markets was necessary to preserve competition in the movement of lower Plains wheat to the Gulf and to Mexico. The lower Plains states of Kansas, Oklahoma and Texas, combined with Colorado, usually produce more than three-fourths of all U.S. hard red winter wheat. A third Class I railroad operating in this corridor was considered necessary to satisfy service concerns and to provide a competitive balance for shippers in these States who would be completely dependent on the Burlington Northern Santa Fe (BNSF) and the UPSP for rail service.

While the STB eventually decided in favor of the merger, the USDA was heartened by the STB's determination to mitigate any potential competitive harm to agricultural and other shippers caused by the merger. The STB imposed 35 specific conditions on the merger, the most important of which was granting nearly 4,000 miles of trackage rights to BNSF to replace the service formerly offered by SP. In granting these trackage rights, the STB made clear that it expected BNSF to compete vigorously for the traffic opened up to it and imposed a common-carrier obligation upon BNSF with respect to this traffic.

Post-Merger Effects

Unfortunately, more than a year after approving the merger, BNSF does not appear to be providing the kind of effective competition the STB required in these movements from Kansas, Oklahoma and Texas to the Gulf and Mexico. The comments from our listening sessions and the numerous contacts we have received by phone, fax, and mail indicate that BNF's presence has been illusory -- as one shipper put it, BNSF "hasn't even shown up on the agricultural side." Agricultural shippers are generally frustrated by the apparent lack of vigorous competition among the only two carriers left in this important corridor, and between the UPSP and the BNSF generally in railroad originations to all destinations from the lower Plains. For instance, some shippers participating at the hearings in Kansas reported that they had been told almost simultaneously by BNSF and the UPSP representatives that both firms would be increasing rates on all domestic and export movements from the lower Plains wheat locations by \$200 a car on September 1, 1997. The appearance of such rate announcements by the two carriers suggests at minimum a lack of vigorous competition between the two carriers and highlights the need for the STB to reexamine the competitive conditions it imposed on movements from the lower Plains.

The STB made it clear that should the BNSF fail to conduct trackage rights operations in movements from the lower Plains, those rights could be terminated and another carrier could be substituted in its place. On the basis of comments received from shippers, the USDA urges the STB to begin a careful and public examination of the competitive situation in rail movements from the lower Plains to the Gulf and Mexico. The scope of BNSF's use of its trackage rights, the performance of the UPSP as the landlord, and any changes in rates and in the adequacy of service which shippers have experienced since the merger should be carefully reviewed.

RAILROAD SERVICE TO MEXICO

Mexico is an important and growing market for U.S. grains and oilseeds. The volumes of U.S. grain being exported to Mexico were at all-time record levels in 1996 largely because of the trade liberalization which occurred from the North American Free Trade Agreement (NAFTA) and the reduction in domestic producer subsidies for basic grains in Mexico which have accompanied trade liberalization. To allow U.S. grain producers to continue to share in the benefits of NAFTA by exporting U.S. grain to Mexico, overland railroad services from the U.S. to Mexico must be competitive. Many small Mexican feed grain importers prefer the small unit sizes of feed grains available by railcar, and cannot handle or afford the minimum ship-size lots of feed grains available by maritime transportation. The USDA has a special interest in the availability of low-cost, competitive overland railroad services to Mexico because it underwrites the importation of almost all U.S. feed grains by Mexican importers through its GSM-102 credit guarantee program. Decreases in the competitiveness of railroad transportation to the border increase purchase prices of U.S. feed grains to Mexican importers and decrease the volume of U.S. feed grains the USDA can underwrite and the U.S. can export to Mexico. Yet, information received by the USDA is that some of the conditions imposed by the STB in the UPSP merger to maintain competitive rail service to Mexico are not being effectively implemented.

USDA believes that it is important for U.S. agricultural exports to Mexico that adequate competition be provided in this market, and we urge the STB to review the implementation of its conditions aimed at preserving railroad competition to the border. Information obtained from U.S. railroad companies indicates that the service provided to the Tex-Mex railway under the

terms of its haulage agreement with UPSP has declined dramatically since the merger. This haulage agreement, which requires the UPSP to provide connecting service between the Kansas City Southern and the Tex-Mex between two Texas interchange points, must be reviewed carefully for its effectiveness in allowing continued access by the Kansas City Southern to the Mexican border through Laredo, Texas, and its new concession route into Mexico. The decline in service experienced by the Tex-Mex may be evidence that a stronger condition such as trackage rights, rather than haulage rights, might be needed to preserve effective competition for U.S. agricultural exporters to the Mexican market.

ABANDONMENT OF THE CENTRAL CORRIDOR LINE

A third major issue relating to the UPSP merger is the future disposition of the Central Corridor line from Salina, Kansas to Pueblo, Colorado. This corridor is particularly important to the wheat growers in southeastern Colorado who annually produce 17 million bushels of wheat, in addition to other crops. Over 70 percent of this wheat is sold on the export market, making the growers heavily dependent on railroad delivery to terminals which are distant from Colorado. Although Colorado shippers are not the only shippers who will be damaged by the loss of this line, their experiences and concerns are representative of the rest of the shippers on the line.

The Central Corridor line was formerly owned by the Missouri Pacific Railroad. Shippers received adequate, reliable and prompt rail service until the Union Pacific purchased the line. Immediately after acquisition of the line, shippers allege that the Union Pacific began to deliberately deny service and downgrade the service provided. In its request to abandon a line segment in the region, UP claimed that the line had carried only 142 carloads the previous year.

A study by the Colorado Department of Transportation estimated a potential demand of 4000 carloads of originated traffic per year on that same line.

Considering the quality of the Union Pacific's prior service and its perceived lack of concern for shippers, many shippers on the Central Corridor line are concerned the UPSP will abandon this line, especially since it now owns a parallel line to the north. Due to reduced competition giving shippers no other viable shipping alternatives, the UPSP can reduce its costs by abandoning this Central Corridor line without losing much of the revenue from the haulage.

If this line is abandoned, wheat growers in the region would be burdened with the extra cost of trucking their grain an additional 60 miles or more to another location on the UPSP rather than hauling it to a local elevator on the nearby former Missouri Pacific line. This additional cost, currently 10-12 cents per bushel, absorbs the price premium being paid by 100 car loadout facilities located on the UPSP main line. The removal of sidings on this Central Corridor line may well result in the certain failure of many independently-owned and cooperative elevators, leaving growers with fewer competitive options and possibly leading to one monopsonistic buyer in some areas. With competing elevators and nearby shipping alternatives removed, there will be little incentive for elevators on the main UPSP line to pay a premium to attract wheat to their facility. In addition, with the removal of rail competition, the USDA anticipates that the price of trucking will also increase. Due to distance, trucking the wheat to the Port of Catoosa, Oklahoma, or Kansas City, Kansas, is not a viable option for these shippers. Thus, the end result will be a decrease in prices received by agricultural producers while their costs continue to escalate, resulting eventually in the erosion of their land values.

The effects upon communities and state governmental units of abandonment of this line

will also be severe. Agriculturally-based local economies will be severely damaged, eroding the local tax base necessary to support basic local services. With the loss of essential transportation services, these rural communities will also be unable to attract alternative industries. Additional trucking will also damage the roads in the region, greatly increasing the costs of road maintenance.

Extensive testimony was received by the USDA at the Kansas listening sessions as to the impacts of anticipated rail abandonments on several rural communities which is expected to occur as a result of the UPSP merger. One of these rural communities is Kiowa County, Colorado, where the 1,700 residents in this rural agricultural community are heavily dependent on UPSP rail service. In 1994, over 5 million bushels of wheat was produced in Kiowa County. The seven grain elevators in the county are equipped to load a maximum of 17 cars each and cannot take advantage of cheaper 100-car unit train rates offered by UPSP. Although the Union Pacific lines through Kiowa County were approved for abandonment in 1996 with the UPSP merger, efforts have been underway to find a buyer for the lines. If a successful bidder is not found soon, the 100 miles of UPSP track in Kiowa county will soon be abandoned.

Representatives of Kiowa county at the Kansas listening sessions reported that Kiowa County has already lost two million dollars in 1997 in assessed property valuation because of the UPSP merger. Two elevators in the county had over 150,000 bushels of grain stored on the ground this past summer because of inability to secure railroad services. Other potential impacts on this rural community from loss of rail service include the loss of \$726,000 in tax revenue, which is 33 percent of the county's budget for schools, hospitals and the municipalities of four small towns. Representatives of Kiowa county at the Kansas listening session stated that the

STB should require that the UPSP continue service to agricultural shippers on the UPSP's Central Corridor line in Kiowa County, Colorado until a short line or regional carrier can take over the trackage.

The UPSP has opened up segments of the Central Corridor for bidding and some shippers believe that segments which are not sold will eventually be abandoned. If any segments in the Central Corridor are abandoned, no other carrier will ever be able provide effective through-route competition on the Central Corridor to the UPSP. The recommendation of the USDA is that the STB require the UPSP to maintain the trackage in this Central Corridor in its entirety at status quo ante levels until its disposition is determined.

Although many short line railroads provide excellent service to agricultural users, the shippers in this area are also concerned that the line will be sold to a firm that is more interested in collecting lease fees than in providing good rail service. Many Kansas shippers complained about significantly-increased lease payments being imposed by the Class I and shortline railroads serving Kansas for leases of railroad sidings and rights-of-way which used to be provided almost free of charge and on which shippers have constructed loading and unloading facilities. Should the STB approve sale of this line to a short line railroad, the USDA recommends that the STB consider using its authority to ensure that the short line railroad purchasing the line maintains an adequate level of service and does not astronomically increase the lease fees charged for the use of rights of way and sidings.

A more economically sound remedy for the STB might be to require the UPSP to divest itself of this Central Corridor line in favor of establishing a third Class I carrier. This is a viable alternative with willing applicants who applied to the STB to buy this line at market prices and

assume operation of the former Missouri Pacific line.

GENERAL POST-MERGER RAIL SERVICE ISSUES

There are other issues relating to rail service of great concern to our constituents, but which are not directly related to the UPSP merger. Although many of these issues are long standing, the decreased level of competition among railroads has greatly increased their severity.

For instance, many agricultural shippers have expressed great concern regarding the new UPSP co-loading policy. Prior to this new policy, a firm operating at several locations could combine the number of cars shipped from each location to obtain a quantity tariff rate. The new policy requires that each location ship the required quantity to obtain that price level. For example, in order to get the 25 car tariff rate under the new co-loading policy, each elevator must ship 25 carloads as a unit. Under the old policy, several elevators could combine their shipments to obtain the 25 carload price.

Additionally, many shippers have reported a decline in the level of rail service since the merger. In particular, many shippers of less-than-unit train lots report they have great difficulty obtaining rail service from the UPSP, and if they do receive service, it is infrequent. The UPSP emphasis on moving unit trains to the reported exclusion of smaller shipments, when combined with the new co-loading policy, will force many elevators to make large investments in sidings just to maintain rail service. It will take long periods of time for many elevators to aggregate the 100 carloads required for a unit train, causing them to hold the grain purchased from farmers for longer periods prior to shipping, significantly increasing their costs, and subsequently resulting in lower prices to farmers.

The alternative scenario is that many smaller shippers will be forced out of business, leaving only those able to load unit trains. The extra cost of shipping by truck to an unit train loading facility will come directly from the farmer producing the grain. In addition to the costs born by the farmers, communities will lose needed tax bases, and states and counties will incur increased road maintenance costs.

Forcing unit trains from each shipper has greater impact upon those shipping wheat and other grains and upon those shipping from more arid regions of the country. It requires a larger area to aggregate a unit train shipment of wheat than it does for one of corn. Unirrigated semi-arid regions of the country also generally have lower yields, and are more dependent on rail service to reach terminal and export markets. The impact upon roads caused by trucking grain to unit loading facilities in these regions will be much greater than in other regions of the United States, creating an additional road maintenance burden upon governmental units in those regions.

Shippers on Class I railroads have also expressed much frustration with the centralized ordering systems. They end up talking with six or eight railroad representatives before reaching anyone who can help them order cars. The next time they call back, they talk with another person they have never dealt with before. When trying to find out why promised cars have not been delivered on time, no one seems to be able to tell them when they will receive the cars. When asked to find out and call the elevator back, they refuse and tell the elevator to call again. Thus, elevator managers have great difficulty in planning the work activities for each day. The new UPSP voucher system for railcars has also been confusing to many shippers.

The result of these car service and car availability problems has been excessive storage of grain on the ground throughout the Midwest. As a result, the elevator expends more labor

handling the grain and considerable deterioration and quality problems occur if it rains on grain stored in such a manner.

The railroads have a common carrier obligation to provide reasonable service to their shippers. On the basis of information provided by shippers, the USDA is convinced that reasonable service has not been provided to smaller agricultural shippers, and recommends that the STB exercise its powers to require Class I railroads improve the level of service to these shippers and to the short line railroads to which they connect. The USDA also encourages the STB to examine the new railroad policy of discontinuing multi-station loading of unit trains, which the railroads have typically allowed in the past.

CONCLUSIONS

USDA appreciates the opportunity to submit comments on the effect of the UPSP merger on agricultural and rural shippers. From its listening sessions and extensive contacts among agricultural interests over the past months, USDA has identified four general categories of concerns related to the impact of the UPSP and other railroad mergers on agricultural shippers.

First, as the USDA has cited in previous comments on the UPSP merger, vigorous competition in lower Plains movements of grain to the Gulf and Mexico is essential to agricultural shippers in the states of Kansas, Oklahoma and Texas. In light of comments the USDA has received about the lack of aggressive competition between the two remaining carriers, USDA recommends that the STB begin a careful examination of the competitive situation in rail movements from the lower Plains to the Gulf and Mexico. Key concerns include the scope of the BNSF's use of its trackage rights, the performance of the UPSP as the landlord, and changes

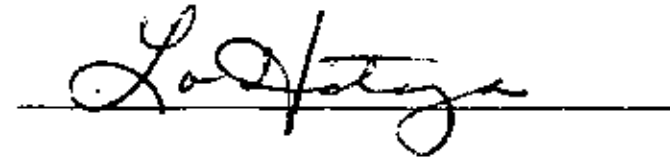
in rates and as to the adequacy of service which shippers have experienced since the merger.

Second, the USDA also believes it is critical for U.S. agricultural exports to Mexico that adequate overland rail competition to this market be maintained and we urge the STB to review and reconsider the effectiveness of its conditions aimed at preserving competition among U.S. railroads to Mexico for their effectiveness. From contacts among U.S. railroad companies, it appears that the service provided to the Tex-Mex railway under the terms of its haulage agreement with UPSP has declined dramatically since the merger.

Third, many shippers have raised concerns to the USDA about the future disposition of the Central Corridor line from Salina, Kansas to Pueblo, Colorado. This corridor is particularly important to the wheat growers in southeastern Colorado who annually produce 17 million bushels of wheat, in addition to other crops. The USDA urges the STB to require the UPSP to maintain the trackage in this Central Corridor in its entirety at status quo ante levels until its disposition can be determined.

Finally, the USDA has also identified other rail service issues not directly related to the UPSP merger but which are of concern to agricultural shippers. One issue the USDA recommends the STB examine is discontinuance by railroads of their policy of allowing multi-station loading of unit trains. The USDA also encourages the STB to consider requiring railroads to provide the same multi-station loading on unit trains that they have in the past -- a policy which allowed several elevators to combine shipments for a lower tariff rate.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Lon Hatamiya", is written over a horizontal line.

Lon Hatamiya
Administrator

Agricultural Marketing Service

U.S. Department of Agriculture
Washington, D.C. 20250

CERTIFICATE OF SERVICE

I, Keith A. Klindworth, certify that on this 15th day of August, 1997, I caused a copy of the foregoing document to be served by first-class mail, postage prepaid, on all parties of record in STB Finance Docket No. 32760 (Sub-No. 21), including counsel for UPSP and counsel for BNSF.

A handwritten signature in black ink, appearing to read "Keith A. Klindworth", written over a horizontal line.

Keith A. Klindworth
Program Manager
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