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May 23, 2005

VIA HAND DELIVERY

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W., Suite 715
Washington, DC 20423-0001

ENTERED
Office of Proceedings

MAY 24 2005

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Public Record



**RE: Finance Docket No. 34549, Illinois RailNet, Inc. – Acquisition
and Operation Exemption – BNSF Railway Company**

Dear Secretary Williams:

Attached for filing are the original and ten copies of the Reply To Supplemental Petition To Revoke Exemption.

Please time and date stamp the extra copy of the Reply and return it with our messenger.

If you have any questions, please contact me.

Sincerely yours,

Karl Morell
Karl Morell

Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34549

ILLINOIS RAILNET, INC.
--ACQUISITION AND OPERATION EXEMPTION--
BNSF RAILWAY COMPANY

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REPLY TO SUPPLEMENTAL PETITION TO REVOKE EXEMPTION

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Attorney for:
ILLINOIS RAILNET, INC.

Dated: May 23, 2005

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34549

ILLINOIS RAILNET, INC.
--ACQUISITION AND OPERATION EXEMPTION--
BNSF RAILWAY COMPANY

REPLY TO SUPPLEMENTAL PETITIONS TO REVOKE EXEMPTION

Illinois RailNet, Inc. ("IR"), hereby replies in opposition to the Supplemental Petition To Revoke Exemption ("Supplemental Petition") filed under seal by the United Transportation Union ("UTU") in this proceeding.

BACKGROUND

On September 27, 2004, IR filed its Notice of Exemption, pursuant to 49 C.F.R. Part 1150, Subpart E—Exempt Transactions Under 49 U.S.C. 10902, to permit IR to acquire the following two rail lines from The Burlington Northern and Santa Fe Railway Company ("BNSF")¹: (1) a portion of BNSF's Oregon Subdivision between milepost 98.75, at Oregon, IL, and milepost 105.78, at Mt. Morris, IL; and (2) a portion of BNSF's La Salle Subdivision between milepost 25.7, at La Salle, IL, and milepost 43.36, at Zearing, IL, a distance of approximately 24.7 miles (the "Rail Lines"). On that same date, IR filed a Notice of Exemption, pursuant to 49 C.F.R. 1180.2(d)(7), in STB Finance Docket No. 34559, *Illinois RailNet, Inc. – Trackage Rights Exemption – The Burlington Northern and Santa Fe Railway Company* (not

¹ Effective January 20, 2005, the name of BNSF was changed to BNSF Railway Company.

printed), served October 18, 2004, seeking the following trackage rights over BNSF rail lines:

(1) local trackage rights on BNSF's rail lines in Oregon, IL for the purpose of servicing BNSF's current customers; (2) overhead trackage rights between BNSF milepost 98.49, near Oregon, and milepost 86.57, near Flag Center, IL; and (3) overhead trackage rights between BNSF milepost 43.36, near Zearing, IL, and milepost 40.73, near Montgomery, IL.

On January 26, 2005, United Transportation Union ("UTU") filed a Petition To Revoke Exemption ("Petition") to which IR responded on February 10, 2005. On March 9, 2005, UTU filed a motion for extension of time and a motion to compel seeking from IR an unredacted copy of the sale agreement. By decision served March 11, 2005, the Board granted UTU's extension request. The Board granted the motion to compel and established the procedural schedule for the filing of the Supplemental Petition and this Reply by decision served April 14, 2005.

REPLY

In its Supplemental Petition, UTU essentially raises two arguments. First, UTU challenges the bona fides of the transaction between IR and BNSF. Second, UTU contends that IR did not receive proper authority to serve the sand plants located between mileposts 98.49 and 100.6. As demonstrated below, neither argument has merit.

UTU contends that the transaction between IR and BNSF "involves several unusual features" from which one can conclude that the purpose of the transaction was to move "jobs out from under a collective-bargaining agreement onto a nonunion carrier." Supplemental Petition at 6. UTU goes on to claim that the transaction was not motivated by "legitimate business goals, that IR is not the "logical entity to be considered as the operator" of the Rail Lines, and that IR "was clearly created for this transaction". *Id.*

In support of its contentions, UTU cites to various provisions in the agreements between IR and BNSF which, according to UTU, demonstrate that BNSF has retained significant control over the operations on the Rail Lines and trackage rights lines. For example, UTU cites to provisions in the Agreement For Sale Of Certain Assets, Rights And Obligations Of The Burlington Northern And Santa Fe Railway Company To Illinois RailNet, Inc. ("Sale Agreement") whereby: (1) BNSF retained certain property interests in the corridors such as a nonexclusive easement for pipelines and fiber optic lines, mineral rights and nonexclusive water rights; (2) BNSF and IR agreed to cooperate in defense of any claims arising out of the parties' respective ownership of the Rail Lines; (3) IR agreed to indemnify BNSF against any claims arising out of IR's ownership and operation of the Rail Lines; (4) BNSF retained the right to establish through routes and rates for traffic moving to or from the Rail Lines; (5) IR agreed to acquire the ability to electronically transmit waybills, consists, bills of lading, Train II reports and passing/placement reports; (6) IR agreed to obtain insurance with BNSF named as an additional insured and not to self insure without BNSF's approval; and (7) BNSF agreed to accept less than the franchise value for the sale of the Rail Lines in return for IR agreeing to a per-car payment for any loaded cars interchanged with railroads other than BNSF.

With respect to the Trackage Rights Agreement, UTU cites to provisions whereby: (1) BNSF retains exclusive control over inspecting and maintaining the trackage rights lines ("Joint Track"); (2) IR agreed not to assign the Agreement without BNSF's approval; (3) IR must install and maintain on its rail equipment such equipment, radios, or devices as may be necessary or appropriate in BNSF's judgment for the operation of trains over the Joint Track; (4) IR is precluded from making any claims against BNSF for any delays on the Joint Track; (5) BNSF

may substitute other tracks for the Joint Track; and (6) IR is required to follow BNSF rules while operating over the Joint Track.

Finally, UTU draws the Board's attention to the provisions in the Agreement For Interchange ("Interchange Agreement") whereby: (1) BNSF has sole discretion to designate the location of the interchange; (2) IR is not required to pay BNSF for use of the interchange track; (3) IR is required to comply with all BNSF operating rules while on the interchange track; (4) IR must secure the appropriate frequency on BNSF's radios while operating over the interchange track; (5) IR employees must be qualified to operate over the interchange track; (6) pilots supplied by BNSF during training are considered IR employees; (7) BNSF has the right to hold disciplinary hearings concerning violations of operating rules by IR employees while on the interchange track; (8) BNSF has the right to perform all rerailling and wrecking services for IR on the interchange track; (9) if necessary, BNSF may repair IR equipment while on the interchange track; and (10) IR is precluded from assigning its rights under the Interchange Agreement without the consent of BNSF.

Contrary to UTU's contention, the arrangement between IR and BNSF is no different than the numerous shortline transactions that the Board and its predecessor have consistently authorized under either Section 10901 or Section 10902 during the past two decades. The various provisions UTU cites in the agreements are far from unusual, as UTU suggests. Rather, these provisions are quite common in agreements between Class I railroads and their shortline partners.

The involved transaction is also not a sham, as UTU suggests, nor was it entered into with the purpose or effect of harming employees that are members of a collective-bargaining agreement. This is an arm's-length transaction entered into by two separate and independent

companies and the transaction is similar to the countless other line sale transactions between Class I railroads and shortline operators sanctioned by the Board and its predecessor. *See e.g.*, STB Finance Docket No. 33960, *Central Illinois Railroad – Lease and Operation Exemption – Lines of The Burlington Northern and Santa Fe Railway Company at Chicago, Cook County, IL* (not printed), served September 12, 2002 (“*Central Illinois*”); and STB Finance Docket No. 32766, *Portland & Western Railroad, Inc. – Lease and Operation Exemption – Lines of Burlington Northern Railroad Company* (not printed), served October 15, 1997 (“*Portland & Western*”).

Unlike the situations in *Burlington Northern R. Co. v. United Transp. Union*, 862 F.2d 1266 (7th Cir. 1988); and Finance Docket No. 32523, *Sagamore National Corporation – Acquisition and Operation Exemption – Lines of Indiana Hi-Rail Corporation* (not printed), served October 28, 1994, IR is a company independent of BNSF and has no affiliation to, or relationship with, BNSF. IR was not created for this transaction as UTU claims. IR was formed in 1997 to acquire certain rail lines from BNSF.² Until recently, IR was a subsidiary of North American RailNet, Inc., a non-carrier holding company that owned several Class III railroads.³ On May 2, 2005, IR and two affiliated Class III rail carriers were acquired by Patrick D. Broe

² See STB Finance Docket No. 33516, *Illinois RailNet, Inc. – Acquisition and Operation Exemption – The Burlington Northern and Santa Fe Railway Company* (not printed), served December 30, 1997; and STB Finance Docket No. 33706, *Illinois RailNet, Inc. – Acquisition and Operation Exemption – Burlington Northern and Santa Fe Railway Company* (not printed), served February 25, 1999.

³ In 1999, North American RailNet controlled five Class III railroads: Nebraska, Kansas & Colorado RailNet, Inc., operating in Nebraska, Kansas, and Colorado; IR operating in Illinois; Camas Prairie RailNet, Inc., operating in Washington and Idaho; Mississippi & Tennessee RailNet, Inc., operating in Mississippi and Tennessee; and Georgia & Florida RailNet, Inc., operating in Georgia and Florida. *See* STB Finance Docket No. 33717, *North American RailNet, Inc. – Continuance in Control Exemption – Georgia & Florida RailNet, Inc.* (not printed), served May 13, 1999.

and BNS Holdings, Inc.⁴ Mr. Broe also controls OmniTRAX, Inc., a noncarrier holding company that controls 12 Class III railroads. Moreover, IR was the most logical entity to acquire the Rail Lines since IR already owned and operated two branch lines contiguous to the Rail Lines.

Also, BNSF has not retained significant control over the operations on the Rail Lines as UTU suggests. IR is responsible for the day-to-day operations on the Rail Lines and for its operations on the Joint Track and any resulting profit or loss. IR meets independently with the existing local customers to discuss service needs and markets new customers in its own name.

The Board was faced with a similar arrangement in *Central Illinois* but nevertheless concluded that the operation of the tracks was not a sham transaction. In so doing, the Board noted that the tenant carrier was an independent corporate entity that is not affiliated with the landlord and that the lease arrangement was an arm's-length transaction. Moreover, the indemnity, claims and insurance provisions in the Sale Agreement are fairly standard practices in the industry and do not detract from IR's independence.

Most shortline railroads look to their Class I connections to establish through routes and rates. In STB Finance Docket No. 33561, *Port of Pend Oreille d/b/a Pend Oreille Valley Railroad – Acquisition and Operation Exemption – The Burlington Northern and Santa Fe Railway Company* (not printed), served October 23, 1998, reconsideration denied by decision served May 2, 2000, the Board found an arrangement between a Class I and a shortline carrier to be arm's length even though the Class I retained the ability to set the rates. *See also Portland & Western*. The ability of BNSF to set the through rates is quite common in the shortline industry

⁴ See STB Finance Docket No. 34687, *Patrick D. Broe and BNS Holdings, Inc. – Acquisition of Control Exemption – Nebraska, Kansas & Colorado RailNet, Inc., Illinois RailNet, Inc., and Georgia & Florida RailNet, Inc.* (not printed), served May 16, 2005.

and provides substantial benefits to both carriers and their customers. IR benefits by not having to provide an extensive national marketing department and can rely on BNSF's national coverage to market IR's local services. The local customers on the Rail Lines also benefit, since they will have to deal with only a single entity in negotiating rates on traffic moving to and from their facilities.

UTU also cites to various provisions in the Trackage Rights Agreement and Interchange Agreement whereby BNSF retains control over certain functions. For example, UTU considers noteworthy the fact that BNSF can discipline IR employees that violate BNSF's operating rules on the Joint Track. These provisions, however, simply provide the method by which BNSF can seek to have an unsafe IR employee removed from the Joint Track and the interchange trackage. This type of provision, as well as the other provisions cited by UTU, are contained in most trackage rights and interchange agreements. *See e.g., Exhibit B, Section 2.15, of the Temporary Trackage Rights Agreement filed with the Board in STB Finance Docket No. 34494, The Burlington Northern and Santa Fe Railway Company – Temporary Trackage Rights – Union Pacific Railroad Company – Kansas City, Mo to Falls City, NE.* Indeed, the Trackage Rights Agreement between IR and BNSF is virtually identical to the agreement entered into by BNSF and Union Pacific Railroad Company in STB Finance Docket No. 34494.

UTU correctly points out that BNSF agreed to accept less than the franchise value of the Rail Lines and IR agreed, in turn, to pay BNSF a set amount for cars interchanged with another carrier. Even more stringent arrangements existed in *Portland & Western*. In reviewing that lease arrangement, the Board noted that:

The lease provisions do for all practical purposes require PWR to route its traffic over BN. But these provisions do not reduce the level of competition that existed in this market before the lease since BN was free to route the traffic it originates over its own

lines. The Board and the Interstate Commerce Commission have consistently held that carriers are not obligated to increase the existing level of competition when they undertake sale or lease transactions such as this one.

Portland & Western, slip op. at 6.⁵

The various terms of the agreements between IR and BNSF that UTU claims are illustrative of a sham transaction have been found by the Board and the Interstate Commerce Commission ("ICC") to be acceptable in similar transactions. For example, the ICC and the Board have approved transactions which: (1) set the maximum amount of revenues the shortline can assess per car as its charge to the connecting carrier; (2) provide for rail line lease payments calculated on a per car basis; (3) allow a Class I rail carrier to obtain a certain percentage of a shortline's operating revenues; (4) authorize a Class I rail carrier to appear as the only carrier in the route in waybills covering shipments to and from points located on a shortline when the shortline is receiving a per car fee from the Class I and not a division of the rate; and (5) allow commercial coordination between the shortline and Class I carrier, where the shortline is not involved in the long-haul. *Minnesota Comm. Ry., Inc. - Trackage Exempt. - BN RR. Co.*, 8 I.C.C.2d 31 (1991) ("*Minnesota Comm.*").

UTU argues that, under the arrangement between IR and BNSF, nothing changes other than the employees of IR replace those of BNSF. In confronting this identical argument, the ICC explained:

⁵ The lease in *Portland & Western* required only nominal rental payment by the tenant, effectively prohibited the tenant from interlining with another connecting Class I carrier, gave the landlord carrier control over the tenant's rates, retained the right of the landlord to operate certain trains over the leased lines, required the tenant to provide certain minimum service levels, provided for a per car payment by the landlord to the tenant carrier, authorized the landlord carrier to control the interline marketing programs of the tenant, and entitled the landlord carrier to handle all claims for loss and damage.

[E]ven if UTU were correct that [the tenant carrier] has replaced [the landlord carrier], this would not show any reduction in competition from the situation prior to the agreement. In fact, the number of competitors would be the same, but an aggressive, responsive competitor would have replaced an older, more rigidly stratified one.

Minnesota Comm., at 39. UTU's argument also overlooks the fact that IR is a financially independent business entity that has no affiliation with BNSF. *See G&MV R. Co. – Exempt. – Consolidated Rail Corp.*, 9 I.C.C.2d 1249, 1255 (1993).

UTU has failed to demonstrate that IR was created exclusively for the purpose of evading labor agreements in order to support the implication that IR is the alter ego of BNSF. *See* STB Finance Docket No. 34509, *Kaw River Railroad, Inc. – Acquisition and Operation Exemption – The Kansas City Southern Railway Company* (not printed), served May 3, 2005 (“Kaw River”); Finance Docket No. 31205, *FRVR Corporation – Acquisition and Operation Exemption – Chicago and North Western Transportation Company* (not printed), served February 28, 1989.

There are many provisions in the Sale Agreement not mentioned by the UTU which demonstrate the independence of IR. The Sale Agreement transfers from BNSF to IR all BNSF's interest in the real estate underlying, and improvements on, the Rail Lines, except for certain limited retained rights that do not pertain to rail service. *See* Paragraph 1 A of the Sale Agreement. In addition, BNSF sold to IR the rail freight transportation business which BNSF previously conducted on the Rail Lines. *See* Paragraph 1 B of the Sale Agreement. BNSF retains no right to operate over the Rail Lines nor may it interfere with or direct IR's operations on the Rail Lines. While the Sale Agreement establishes a business relationship between IR and BNSF for interchange traffic between the parties, that relationship is no different than the numerous other shortline-Class I arrangements entered into in the last two decades.

These and other provisions of the agreements demonstrate that IR is not an agent or lackey of BNSF nor is the arrangement between IR and BNSF a sham. The provisions of the Sale Agreement demonstrate that there are valid commercial reasons underpinning this transaction.

UTU also argues that IR did not receive proper authority over the trackage between mileposts 98.49 and 100.6 to serve the two sand shippers Unimin and H.A. International. UTU claims that IR has been running trains between those mileposts to serve the two shippers located west of downtown Oregon without having obtained the necessary authority in either this proceeding or in STB Finance Docket No. 39559. UTU complains that IR and BNSF did not specify by milepost designation the location of the customers IR is able to serve on the Joint Track.

In STB Finance Docket No. 39559, IR applied for and was granted the following trackage rights: (1) local trackage rights for the purpose of servicing customers on BNSF in and around Oregon, IL; (2) overhead trackage rights between milepost 98.49, near Oregon, and milepost 86.57, near Flag Center, IL; and (3) overhead trackage rights between milepost 43.36, near Zearing, IL, and milepost 40.73, near Montgomery, IL. The two sand shippers identified by UTU are located on the Joint Track west of Oregon. While UTU is correct that the track over which IR has local trackage rights was not identified by milepost designations in the Trackage Rights Agreement, BNSF and IR were of the opinion that the trackage at issue could be more clearly defined by a map rather than milepost designation. The trackage at issue and the two industries IR is able to serve under the local trackage rights are illustrated on page 2 of Exhibit C-1. A copy of that map is attached. Consequently, UTU's concerns are misplaced. IR received authority to serve BNSF's currently located customers in Oregon, IL and the specific location of

the track at issue and the customer facilities are set forth in the Exhibit to the Trackage Rights Agreement.

Finally, UTU argues that the exemption should be revoked to carry out the rail transportation policy. The standard for revoking an exemption is whether regulation is needed to carry out the rail transportation policy of Section 10101. 49 U.S.C. § 10502(d). Petitions to revoke must be based on reasonable, specific concerns demonstrating that reconsideration of the exemption is warranted. *Minnesota Comm.*, at 35-36; *Portland & Western*; Finance Docket No. 31617, *Chesapeake & Albemarle R. Co. – Lease, Acq. & Oper. Exemp. – Southern Ry. Co.* (not printed), served September 19, 1991; Finance Docket No. 31102, *Wisconsin Central Ltd. – Exemp. Acq. & Oper. – Certain Lines of Soo L.R. Co.* (not printed), served July 28, 1988.

The party seeking revocation of an exemption has the burden of proving that regulation of the transaction is necessary. *Id.* Here, UTU has simply come forward with unsupported and unsupportable assertions that revocation is necessary to carry out the national transportation policy. Because UTU has submitted no evidence in support of its assertions, it has failed to meet its burden of proof and its Petition, as supplemented, must be denied.

Where, as here, an exemption has become effective, a revocation request is treated as a petition to reopen and revoke and, under 49 C.F.R. § 1115.3(b), must state in detail whether revocation is supported by material error, new evidence, or substantially changed circumstances. UTU has failed to address these standards much less introduce any evidence to warrant a finding favorable to UTU under these standards.

Moreover, the Board's analysis focuses on the sections of the rail transportation policy that are related to the underlying statutory section from which the exemption was granted. *Minnesota Comm.*, at 36. The Board does not revoke exemptions "because a section of the [rail

transportation policy] *unrelated to* the underlying section of the statute requires revocation.” *Id.*, at 37. In addition, the Board does not extend its analysis beyond the issues that it would address in an application proceeding. *Id.*, at 36-37.

In its Petition, UTU cites one section of the rail transportation policy, 49 U.S.C. § 10101(11), which encourages fair wages and safe and suitable working conditions in the railroad industry. The Supplemental Petition makes no mention of this or any other provision in the rail transportation policy. In any event, UTU fails to explain: (1) why any section of the rail transportation policy compels the revocation of the exemption in this proceeding; (2) the relevance of any section of the rail transportation policy to Section 10902, the underlying section of the statute otherwise applicable to this transaction; or (3) the manner in which the involved transaction produces unfair wages or unsafe working conditions. In fact, UTU has failed to demonstrate that any employee of BNSF was adversely affected by the transaction. Thus, there is no evidence from which the Board could find that labor impacts are so severe as to warrant regulatory scrutiny through a more formal process. *See Kaw River*, slip op. at 9.

Granting UTU’s request would require IR to file an individual petition for exemption under Section 10502 or an application for the acquisition of the Rail Lines under Section 10902. Under Section 10902, the Board would be required to grant the application unless it finds that the acquisition of the Rail Lines by IR is inconsistent with the public convenience and necessity. Transactions initiated under Section 10902 were deemed by Congress to be consistent with the public convenience and necessity unless shown to be otherwise. In any event, UTU fails to explain the manner in which this transaction is inconsistent with the public convenience and necessity. Moreover, the Board may not impose labor protection when a Class III rail carrier obtains a certificate under Section 10902. 49 U.S.C. § 10902(d). Consequently, granting UTU’s

request would serve no useful purpose. IR would be forced to incur the significant expense of filing a petition for exemption or application. In all other respects, however, the parties and the Board would simply come full circle to the same result. It is inconceivable that the UTU could demonstrate that this transaction is inconsistent with the public convenience and necessity and the Board is powerless to impose labor protection in a proceeding initiated by a Class III railroad under Section 10902.

The transaction involved in this proceeding is the very type of procompetitive transaction that the Board and the ICC have repeatedly endorsed and affirmed. As the ICC noted:

[I]t has been our experience with transactions of this type that the acquiring firm will bring new vitality to the line. Typically, the new operator has closer ties to local communities and will provide better service, often at lower rates, and will work closely with shippers on the line.

Finance Docket No. 31089, *Montana Rail Link, Inc. - Exemption Acquisition and Operation - Certain Lines of Burlington Northern Railroad Company* (not printed), slip op. at 21, served May 26, 1988. As a locally based carrier, IR will be able to provide more efficient, economical and attentive service to the customers on the Rail Lines and in Oregon, IL on the Joint Track. To the extent IR's services are more efficient and economical, the transaction will lead to improved service at lower rates for existing and future shippers.

CONCLUSION

IR respectfully urges the Board to deny the Petition, as supplemented, for failing to meet the revocation standards set forth in 49 U.S.C. § 10502(d). UTU has presented no facts or arguments that meet the Board's revocation standard or that otherwise warrant the revocation of the exemption in this proceeding.

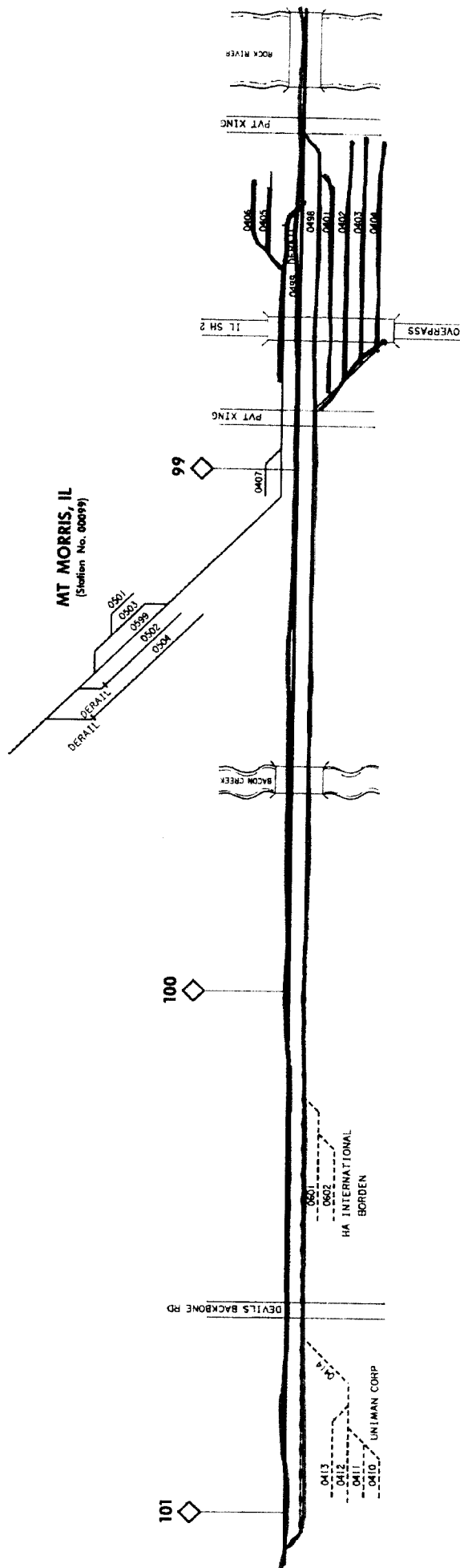
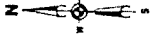
Respectfully submitted,



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Attorney for:
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Dated: May 23, 2005



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 FOREIGN TRACK



OREGON, IL
Aurora Subdivision

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FSAC: 00098	TEAM: OREG04065.DGN

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of May, 2005, I have caused a copy of the foregoing

Reply to Supplemental Petition To Revoke Exemption to be served on:

Daniel R. Elliott, III
Associate General Counsel
United Transportation Union
14600 Detroit Avenue
Cleveland, Ohio 44107


Karl Morell