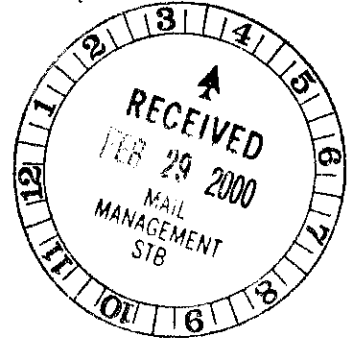




February 29, 2000



Via Hand Delivery

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

DC WM
DONELAN CLEARY WOOD & MASER, P.C.

FEB 29 2000

Part of
Public Record

Re: STB Ex Parte No. 582, *Public Views on Major Rail Consolidations*

Dear Secretary Williams:

Please find enclosed for filing in the above-referenced proceeding an executed original and ten (10) copies of the Comments of Western Resources, Inc. Also enclosed is a 3.5-inch diskette containing a WordPerfect 7.0 formatted copy of this filing. An extra copy of the filing is enclosed for stamping and return to our office.

Should you have any questions concerning this filing, please do not hesitate to contact the undersigned. Thank you for your cooperation and assistance in this matter.

Respectfully submitted,

A handwritten signature in cursive script that reads "Thomas W. Wilcox".

Thomas W. Wilcox

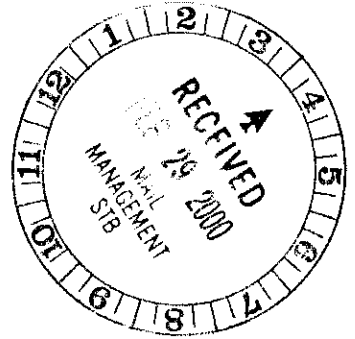
Enclosures

ATTORNEYS AND COUNSELORS AT LAW

1100 New York Avenue, N.W., Suite 750, Washington, D.C. 20005-3934, Tel: 202-371-9500, Fax: 202-371-0900

197254

**BEFORE THE
SURFACE TRANSPORTATION BOARD**



STB Ex Parte No. 582
PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

COMMENTS OF WESTERN RESOURCES, INC.

FEB 29 2000

Part of
Public Record

Western Resources, Inc. ("Western"), a generator of electricity that ships approximately 11 million tons of coal by rail from mines in the western United States to Western's coal-fired facilities in Kansas, hereby offers the following comments on major rail consolidations for inclusion in the official record in this docket. Western's comments are generally responsive to the points raised in the Board's decision served in this proceeding on January 24, 2000.

I.

SUMMARY OF COMMENTS

The operation of Western's electric generating plants has been directly and negatively impacted by the merger of the Burlington Northern Railroad Company ("BN") and The Atchison, Topeka & Santa Fe Railway Company ("Santa Fe")¹, and the merger of the Union Pacific Railroad Company ("UP") and the various rail lines making up the Southern Pacific lines ("SP").² The adverse impacts to Western have been both economic and operational. Western participated as a Party of Record in each of those merger proceedings, and it intends to also participate as a Party of Record in any proceeding involving a proposed merger of BNSF or UP

¹ ICC Finance Docket No. 32549, *Burlington Northern, Inc. and Burlington Northern Railroad Company – Control and Merger – Santa Fe Pacific Corporation and The Atchison, Topeka & Santa Fe Railway Company*, decision served August 23, 1995.

² STB Finance Docket No. 32760, *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*, decision served August 12, 1996.

and another rail carrier, including the proposed merger of BNSF and Canadian Railways, et al. ("CN").

Based on the disappointing and costly efforts to implement the most recent major railroad mergers, it must be expected that the next rail merger, whether it is the proposed merger of BNSF and CN or if it is the merger of any of the other Class I railroads, will result in significant service disruptions and economic losses to rail customers, many of whom are like Western in that they are still suffering the ill-effects of recent rail mergers. For Western, the possibility of further harm to it from the implementation of a rail merger involving either UP or BNSF causes it to ask the Board to defer consideration of any future merger that would involve BNSF or UP until these railroads can establish convincingly that they provide consistent, reliable service to their customers, particularly their coal shipper customers.

Moreover, the railroad mergers that have occurred to date have produced a rail system where competition between major railroads has been reduced, rail service has become undependable, and the railroads have indicated that the solution to their problems is to retrench, restrict capacity, concede business to modes of transportation their mergers were supposed to take business from, and begin to move away from contract service and raise the rail rates of shippers who have no choice but to use the railroad to move their commodities. This cannot be what the STB expected from the rail mergers it has approved, but these problems will carry over to future mergers, and will in all likelihood be exacerbated by the increased size of the rail systems involved and the increased concentration of market power into the hands of fewer major players, unless substantive changes are made to existing law and policy to promote and maintain competition and adequate service levels. Such changes are particularly needed if in fact there are eventually to be only two railroads in North America, as many have speculated. Western has outlined several measures for the Board to consider to accomplish this result.

II.

IDENTITY OF WESTERN RESOURCES, INC. AND RELEVANT FACTS

Western Resources is a consumer services company headquartered in Topeka, Kansas with interests in monitored security and energy. Western's utilities, KPL and KGE, provide electric service to approximately 620,000 customers in Kansas. Western owns several coal-fired electric generating stations that in total burn approximately 11 million tons of coal each year that

must be delivered by the BNSF and UP. Western's Jeffrey Energy Center, in St. Mary's, Kansas northwest of Topeka, alone requires approximately nine million tons of coal each year to provide electricity to satisfy the needs of Western's wholesale and retail customers. This coal is delivered by UP and BNSF in a joint line contract movement from mines in the Powder River Basin in Wyoming. Western's Lawrence and Tecumseh Energy Centers, located on the line of BNSF between Topeka and Kansas City, each presently burn around one million tons of coal per year which is delivered by the UP and BNSF from mines in Colorado in joint line service. Reliable, reasonably priced rail service is therefore essential to Western's utility operations. Unfortunately, with the advent of railroad consolidation beginning with the merger of BN and Santa Fe in 1994, the level of rail service to Western's plants has declined, but the rates for this service have remained high.

III.

TO AVERT THE REAL RISK OF FURTHER ECONOMIC
LOSS TO COAL SHIPPERS FROM RAILROAD SERVICE PROBLEMS
FURTHER CONSOLIDATION OF THE RAILROAD INDUSTRY SHOULD NOT BE
PERMITTED TO OCCUR AT THIS TIME

In the view of Western and many other rail customers, the consolidation of major railroads in the western United States to essentially two has been accompanied by extended, significant, and very costly complications and disruptions in rail service. Moreover, this consolidation has occurred with very little of the so-called "synergies," cost savings, and expansion from new business touted by the merger applicants in their merger proceedings. Despite the broad, sometimes hyperbolic, representations of BNSF and UP to the contrary, the reduction of the number of major rail carriers in the west to two has resulted in an overall decrease in rail competition and a reduction in quality of rail service. In the case of Western and other shippers of western coal on the BN, Santa Fe, UP, and/or SP, the mergers of these four railroad systems into two meant massive service disruptions, non-communication due to railroad organizational restructuring, economic losses by shippers, and strained business relationships. Specific examples of problems that occurred as a result of the BN/Santa Fe and UP/SP mergers, which continue to occur, and which Western believes will be the aftermath of a merger between BNSF and CN and any further railroad consolidations prompted by that merger, include (1) the diversion of locomotive power and crews to other parts of the rail system at the expense of coal

customers; (2) parking or diverting coal trains for long periods of time, resulting in coal not being delivered; and (3) substantial congestion at origins and interchange points. In Western's case, these disruptions have occurred despite the existence of contractual obligations the railroads have to deliver coal to Western's plants in a certain manner and time.³

The railroads' failure to effectively and timely obtain anticipated efficiencies and public benefits from their mergers resulted in substantial disruption to the operations of Western's generating facilities and damages to the company as a whole. The merging railroads, particularly UP and SP, added to the harm inflicted on Western and other shippers by misleading the rail shipping community and this Board regarding the full extent of their problems and the timing for their resolution. Western's damages include tens of millions of dollars in economic losses. These economic losses extend far beyond the typical direct costs of poor service, such as reimbursement of car lease costs, replacement trains, or liquidated damages. While the BNSF and UP each make claims of rail service improvements on their systems, railroad service to the Jeffrey Energy Center and to the Lawrence and Tecumseh Energy Centers remains inconsistent to this day.

The Board and shippers in general must evaluate the prospect of future railroad mergers assuming that costly service disruptions will occur again, and perhaps on even a greater scale than before due to the increased size of the rail systems and business organizations involved. The question to consider, therefore, is whether rail shippers, the rail industry, and the Nation's economy can withstand the widespread and costly rail service disruptions that another major rail merger will bring. To Western, whose rail service has still not recovered from the mergers of UP/SP and BN/Santa Fe, the answer is clearly "No." The STB should not permit any merger involving the UP or the BNSF until these carriers can convincingly show that they are providing reliable rail service to their present customers, particularly their coal shipper customers. In addition, as outlined below, any future consolidation of the railroad industry must be accompanied by changes to existing law and policy.

³ The damages caused to Western by the reduction in service levels of BNSF and UP to the Jeffrey Energy Center after their mergers have been extraordinary. The severity of the problems is underscored by the fact that on January 24, 2000, Western took the extraordinary measure of filing suit against the railroads in Kansas Federal District Court to recoup the damages caused by railroads' material breach of their contract with Western to provide rail service to the Jeffrey Energy Center.

IV.

CONSIDERATION OF FUTURE MERGERS MUST BE ACCOMPANIED BY CHANGES TO EXISTING POLICIES AND LAWS REGARDING CAPTIVE SHIPPERS

A central question which must be decided now is: "If the timing is not right for a merger of BNSF and CN, then when is the right time?" Western's answer to this question is: "Not until changes are made to existing policies and law to protect captive shippers and promote competition between major rail carriers." There has been much speculation over whether the merger of BNSF and CN is the beginning of an "end game" in which only two major railroads are present in North America. Regardless of whether this comes to pass – and Western does not doubt that it may in fact come to pass – if the STB's goal is to promote marketplace solutions to railroad industry issues rather than a system of "command and control" regulation, the STB should not approve any additional consolidation of the railroad industry without revising its current policies to provide meaningful relief and options to captive shippers.

The reasons for this position are many, but in general the railroad industry must grow and expand to survive long term, and the most efficient way to accomplish this result is to promote competition between the players in the industry. With competition come incentives to operate efficiently, price competitively, and provide better service. Despite the statements made by BNSF and UP about the degree to which they compete, their duopoly in the west has translated into less competition and poorer service as a general matter, particularly for captive shippers.⁴ Further railroad consolidation, particularly a merger involving either BNSF or UP, will not improve this situation, and might even make it worse. For instance, what will be the fate of the Dakota, Minnesota & Eastern Railroad as a possible alternative to BNSF or UP for coal transportation if further consolidation takes place? In addition, does the STB truly believe that the Kansas City Southern Railway, a current alternative available to a few coal shippers, will be able to survive further concentration of market power in the hands of the major railroads? Examples of problems with the current state of affairs are as follows:

⁴ For this reason, Western believes the STB's policies and laws should be revised along the lines suggested in these comments regardless of whether any further railroad industry consolidation takes place.

A. The “Bottleneck” and Competitive Access Rules Provide Little Comfort to Captive Coal Shippers

To Western’s knowledge, since the issuance of the bottleneck rules in 1996, there have not been any instances in which either the BNSF or the UP have provided a “non-bottleneck,” competitively-priced⁵ rail transportation contract to a rail shipper when the other railroad has a monopoly over the “bottleneck” portion of the overall movement. On the other hand, there have been numerous anecdotal accounts of instances where the BNSF and UP have refused to provide a competitively-priced contract over the non-bottleneck segment for fear of repercussions in situations where the carriers’ roles are reversed.⁶ This behavior will not change for the better unless changes are made to the bottleneck rules before another rail merger involving UP or BNSF.

Moreover, even in the unlikely event that a captive coal shipper was able to secure a competitively-priced contract from the non-bottleneck carrier, the bottleneck rules permit the bottleneck railroad to refuse to supply a bottleneck rate to go with the contract if both railroads serve the same mine origin. In order to try to obtain a bottleneck rate under these circumstances, the shipper must file a competitive access case under the Board’s regulations. 49 CFR Part 1144. However, no shipper has ever succeeded in establishing access under these regulations. Nevertheless, this rule means that any coal shipper who purchases coal from mines served by both UP and BNSF – which includes many mines in the Powder River Basin of Wyoming - is precluded from bottleneck rate relief unless it is willing to file a competitive access case.

The combination of these two aspects of the bottleneck rules has produced a predictable result: not one western coal shipper has filed either (1) a complaint seeking the prescription of a bottleneck rate from BNSF or UP to be used in conjunction with a competitively-priced contract with the other carrier; or (2) a petition seeking competitive access to an interchange point for the

⁵ By “competitively-priced,” Western means a contract rate over the non-bottleneck segment that, when combined with a prescribed rate over the bottleneck segment, results in an overall rate that is less than the maximum reasonable rate that would be calculated for the entire movement from origin to destination (usually 180% of variable costs in the case of coal movements).

⁶ These accounts have become sufficiently numerous that Senator Kay Bailey Hutchison, Chair of the Senate Commerce Committee Subcommittee on Science and Transportation, mentioned this behavior on the part of these and other Class I railroads during the Subcommittee hearing on Chairman Morgan’s renomination held on September 28, 1999.

purpose of using a prescribed bottleneck rate from one of the two railroads in conjunction with a competitively-priced contract with the other over a non-bottleneck segment. Before the STB approves further consolidation of the rail industry, particularly a merger involving either BNSF or UP, the bottleneck rules must be changed, either within the merger context in the form of conditions, or outside the merger context, so that they provide captive coal shippers a real opportunity to take advantage of competition on segments of their overall coal transportation movement where it can exist.

B. The Lack of Effective Competition Has Meant That Service Has Deteriorated But That Rates are Going Up

The present lack of meaningful competition between the railroads, which will only decrease in the event of additional future industry consolidation, is demonstrated by the facts that the major railroads are shedding lines through abandonments and sales, thereby shrinking the sizes of their systems instead of growing, and, more significantly, they are raising the prices for their services even though they admit that service to their customers is deteriorating.

As to line sales, it is significant to note that the sale of a particular line of rail by a larger railroad to a smaller rail line is often accompanied by “paper barriers” that prevent the purchaser of the line from competing with the selling railroad or otherwise restrict the use of the track by the purchaser. The Board recognized the existence of these potential barriers to competition and operating efficiency in its *Review of Rail Access and Competition Issues*, undertaken in Ex Parte No. 575.⁷ However, any public examination of the existence and adverse effect of paper barriers on competition and service in that proceeding was cut off by the Board when the Association of American Railroads (“AAR”) and the American Short Line and Regional Railroad Association (“ASLRRA”) entered into an agreement addressing paper barriers.⁸ The Board has never revisited the paper barrier issue to examine whether the current rules and the AAR/ASLRRA arrangement provide effective relief to captive shippers in an environment where the market power of major railroads is continuing to increase.

⁷ See, STB Ex Parte No. 575, decision served April 17, 1998 at 8.

⁸ See, STB Docket No. S5R 100, *Association of American Railroads and American Shortline Railroad Association – Agreement – Application Under 49 U.S.C. 10706*; See also STB Ex Parte No. 628, *Expedited Relief for Service Inadequacies*, decision served October 22, 1998, (denying petition of coal shipper group to conduct rulemaking proceeding on anticompetitive effects of paper barriers).

Second, the Board should be particularly alarmed by the recent announcements by the major rail carriers that they want to move away from contracted services and toward transportation by tariffs at higher overall rates⁹ to be determined by some form of "congestion pricing." These announcements have come in conjunction with statements by the major railroads that capacity on their systems is constrained but that they nevertheless do not expect to increase capital investment in 2000. This concept of pricing services based on what those who value it most will pay is reasonable only where there are multiple providers available to supply the service and where it is likely that higher prices will induce additional investment to serve market demand. However, in an increasingly concentrated railroad industry, its implementation would only ensure monopoly profits to the railroads. The consolidation of the railroad industry has resulted in less competition and decreased incentives for the few remaining players to compete with one another in a concentrated market, and it is becoming apparent that the railroads instead intend to rely more heavily on profits from higher rates to shippers who must use the rail lines to transport their products. It is significant that none of the railroads has accompanied its announcement of rate increases with penalty-based performance guarantees.¹⁰

The railroads' intention to raise prices and not increase investment in capacity is contrary to virtually all of the representations they made to the STB in their respective merger proceedings regarding cost savings, revenues from new business, and system expansion.¹¹ The recent actions of the major railroads regarding pricing is a signal that (1) they have conceded the

⁹ "Railroads Attempt to Raise Prices," *Journal of Commerce*, February 11, 2000; "Railroad Companies Raising Freight Rates," *Rueters*, February 9, 2000; "CSX Chairman Sees a 'Seller's Market,'" *Journal of Commerce*, February 7, 2000; "Pricing Change," *Traffic World*, February 7, 2000.

¹⁰ Western notes that BNSF and CN have recently made general statements about providing service "guarantees" as part of their merger, but the carriers have provided few details and the information provided to date indicates that these promises do not appear to extend past the carriers' well-established liability for service-related direct costs under existing law.

¹¹ In justifying their merger, BN and Santa Fe boasted that their merged railroad would, among other things, result in (1) cost savings of \$453 million annually, (2) increased traffic, revenues and earnings due to the attraction of new single line and intermodal truck traffic to the combined system, and (3) diversification of the applicants' traffic base, "balancing BN's strengths in coal and grain with Santa Fe's strengths in intermodal traffic." Finance Docket No. 32549, decision served August 23, 1995 at 9-10.

For their part, UP and SP asserted that the "annual quantified public benefits" of their merger would be in excess of \$750 million annually, and that the merged railroad would be more efficient and competitive with BNSF. UP/SP also stated that their merger would generate benefits to the merged railroad in the amount of \$659.1 million each year, \$76.0 million of this amount being new business, and \$583.1 million in cost savings. Finance Docket No. 32760, Decision served August 12, 1996 at 15-16.

loss of all or nearly all of their marginally competitive traffic to trucks and other modes of transportation; and (2) they intend to maximize profits through the exercise of monopoly power against bulk commodity shippers who have no choice but to ship by rail. If allowed to occur – and the possibility of this scenario becomes more real as participants in the rail industry are reduced via consolidation – then even coal shippers who have access to two railroads for their entire rail movement will see the level of their rates increase, unless an effective regulatory or market-based remedy is available to constrain the ability of the remaining carriers to increase prices and to further reduce service levels.

V.

CHANGES TO EXISTING RAIL POLICY AND LAW THAT SHOULD PRECEDE ANY ADDITIONAL CONSOLIDATION OF THE RAILROAD INDUSTRY

The current policies and laws governing railroads have resulted in a rail industry with very few major players who do not effectively compete against one another, and who do little to provide reliable and adequate service to their customers. Moreover, there is little meaningful recourse to shippers, particularly coal shippers, who have facilities that are captive to either BNSF or UP for rail service, to improve their rates or service terms to levels approaching those enjoyed by shippers with access to both carriers at the origin as well as the destination of a coal movement. At a minimum, the STB should preclude future railroad consolidations, particularly mergers that involve either the UP or BNSF, unless it makes the following revisions to existing law and policy, either within the merger context in the form of conditions, or outside the merger context in the form of regulations or legislative initiatives:

1. The policy of attempting to preserve pre-merger competition and service levels—a policy that has not achieved its intended result—should be changed to a policy of enhancing the competitive options of rail service provided to captive shippers. To this end, the STB should expand its policy of modifying contractual relationships between captive shippers and merging railroads if a captive shipper can demonstrate that service to its facility has deteriorated as a result of the merger. In such cases, the STB should include among possible remedies (1) the adjustment of the rate aspects of the arrangement in light of the deteriorated service levels, and/or (2) modifying contract volume requirements and providing rights to another railroad to provide rail service to the facility on a temporary or permanent basis.
2. The STB's bottleneck rules should be revised to permit a captive shipper to request and obtain a rate over a bottleneck segment even though the shipper may not yet have a

contract for the non-bottleneck segment of its overall route. Determining the maximum reasonable level of this rate first would be more likely to prompt competition between the non-bottleneck railroads.

3. The STB's bottleneck rules should be revised to eliminate the "same origin" restriction. In the alternative, the STB should liberalize and spell out in detail the standards it would apply to a petition for competitive access in the event a captive coal shipper was able to secure a contract from a same-served origin to an interchange point with the bottleneck carrier. The rules should be particularly liberal in situations where the interchange point selected by the shipper is already being used by the carriers.
4. The STB should adopt rules, or a set of merger conditions, that reflect a policy that railroads other than the remaining Class I railroads will be encouraged to play an active role in providing captive shippers competitive transportation alternatives to the major Class I carriers. Such a policy would entail the elimination of paper barriers that inhibit such participation, public funding for infrastructure developments and track upgrades in order to accommodate the equipment being used by the Class I carriers, and reasonable access and interchange terms over Class I rail lines where needed to advance the policy of facilitating competition and the establishment of viable alternatives for captive shippers. This policy could also include a re-examination of the effect of the BN/Santa Fe and UP/SP mergers on coal transportation in the western United States.

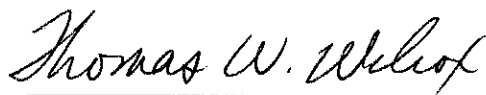
If in fact the railroad industry continues to be consolidated to the point that only two railroads remain, then Western believes that the present problems and deficiencies in the railroad industry will be magnified, and that the Board might well be required to take more precipitous action if it truly wishes to see railroad rate and service issues resolved through competition and market-based solutions. Such action would likely include providing the railroads with access

over each other's rail lines or similar relief, all which would require the Board to be proactive and vigilant to deter the natural duopolistic tendencies of the remaining two carriers.

Respectfully submitted,

Martin J. Bregman
Executive Director, Law
WESTERN RESOURCES, INC.
818 Kansas Avenue
P.O. Box 889
Topeka, KS 66601
(785) 575-1986
(785) 575-8136 (fax)

Don Barry
BARRY LAW OFFICES
5340 S.W. 17th Street
P.O. Box 4816
Topeka, Kansas 66604
(785) 273-3153
(785) 273-3159 (fax)



Thomas W. Wilcox
Scott A. Harvey
DONELAN, CLEARY, WOOD & MASER, P.C.
Suite 750
1100 New York Avenue, N.W.
Washington, DC 20005-3934
(202) 371-9500
(202) 371-0900 (fax)

Counsel for Western Resources, Inc.

February 29, 2000