BEFORE THE

Interstate Commerce Commission

FINANCE DOCKET No. 22688, ET AL.

In the Matter of:
CHICAGO & NORTH WESTERN RAILWAY COMPANY
— CONTROL —
CHICAGO, ROCK ISLAND & PACIFIC RAILROAD COMPANY, ET AL.

BRIEF OF INTERVENOR CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY

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The Chicago, Milwaukee, St. Paul and Pacific Railroad Company, hereinafter sometimes called "Milwaukee," Intervenor in the above proceeding, files this its opening brief in support of its intervention in the above proceeding.[1]

[1] Embraces: Chicago & North Western Railway Company-Control-Chicago, Rock Island & Pacific Rail oad Company, F.D. No. 22688; Chicago & North Western Railway Company-Issuance of Securities, F.D. No. 22689; Union Pacific Railroad Company-Control-Chicago, Rock Island & Pacific Railroad Company, F.D. No. 23285; Union Pacific Railroad Company and Chicago, Rock Island & Pacific Railroad Company, Merger, F.D. No. 23286; Union Pacific Railroad Company-Issuance of Securities, F.D. No. 23287; Southern Pacific Company-Purchase (Portion)-Chicago, Rock Island & Pacific Railroad Company, F.D. No. 23595; Southern Pacific Company-Assumption of Obligations, F.D. No. 23596; Atchison, Topeka & Santa Fe Railway Company-Purchase, Etc.-Chicago, Rock Island & Pacific Railroad Company (Por-

PRELIMINARY STATEMENT

The location of the Milwaukee's lines of railroad, the nature and scope of its operations and reference to various financial data, as well as its position with respect to the competing applications and various petitions and proposed conditions are all set forth with some particularity in the joint brief of the railroad parties and will not be repeated in this separate brief. This separate brief will attempt to develop the rationale for its position on the several facets of this case. The argument to follow will contain necessary references to the record where relied upon for factual data or expert opinion, but no effort will be made to give references to all of the sources of fact or opinions in the record where they merely confirm the source cited.

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tion), F.D. No. 23919; Atchison, Topeka & Santa Fe Railway Company-Assumption of Obligations, F.D. No. 23920; Southern Pacific Transport Company-Purchase (Portion) Rock Island Motor Transit Company, Docket No. MC-F-9222; Union Pacific Railroad Company-Construction, F.D. No. 24128; Union Pacific Railroad Company and Chicago, Rock Island & Pacific Railroad Company—Abandonment, F.D. No. 24129; Atchison, Topeka & Santa Fe Railway Company-Common Use of Terminal Facilities-St. Louis-San Francisco Railway Company, F.D. No. 24154; The Santa Fe Trail Transportation Company (Wichita, Kansas)-Purchase (Portion) — The Rock Island Motor Transit Company (Des Moines, Iowa), Docket No. MC-F-9668.

ARGUMENT

I.

INTRODUCTION

The railroads of the nation are a national resource. Regardless of who the present security holders are, railroad plant and services represent the ingenuity and the savings from the labor of several generations. In a sense, the national railroad system is a national heritage. But railroads, individually and collectively, are meant to be maintained and used in a practical way for practical purposes, not as museum pieces. When parts of the whole or if individual units become obsolete or excess to the transportation needs of the country over an extended period of time the public will not patronize or support these parts, nor should they be expected to do so.

To paraphrase Senator Cummins during the debates preceding the Transportation Act of 1920 and return of the railroads to private management: Transportation is a public function, but it can be best performed under private ownership and private management.[2] This simply means that transportation should be subject to the same diciplines in the use of funds as other private business to the fullest extent possible.

Under regulation, railroads are required to be reasonable in their rates and to avoid all forms of undue discrimination or preference and prejudice to the end that transportation by railroad should not unduly advantage one shipper or one territory over another. For the same reasons the relative earning power of individual rail-

[2] Congressional Record—66th Congress, First Session, Vol. 58, Part 5, p. 4596.

roads or regional groups should not cause undue disadvantages for some areas and not for others.

Congress has recognized, however, that competition among railroads can be either beneficial or ruinous and has given to the Commission the power to limit the competitive forces within the industry which might otherwise permit railroads to construct or acquire unneeded lines or otherwise allow the strong to overpower the weak.

As a general proposition, railroads are geography and their respective success or failure is not one of management but of the territory they predominantly serve and its need for rail transportation.

There is, however, a big difference between railroads and other forms of transportation, aside from the fact that they own, maintain and operate their own rights of way, and pay taxes on them. One of these differences is that railroads for many years have been required to interchange freight between carriers without the transfer of lading. To implement this there is not only a body of law but a system of railroad-made rules which promote the free interchange of freight at established junctions and to encourage cooperation among the carriers to provide an integrated system. Other modes have never been required by law to do this. Consequently, the free interchange of equipment among other modes has never developed to the same extent. Accordingly, single line service does not have the same significance among railroads as it does to motor carriers.

Motor carrier mergers and acquisitions have tended toward extensions of operating authority into new origin and destination territory in order to extend single line service to more points to avoid interchange of lading. Railroads already have an integrated rail system and they can improve service best by concentrating volume over fewer parallel and competing routes by consolidating railroads within a region. Railroads assemble trainloads, whereas, trucks assemble truck and trailer loads. Consequently, trucks are not so interested in concentrating traffic over a few routes because this is not so important in terms of cost or service. The number of highway routes used has no bearing on truck cost.

The key question in this case is whether better service will accrue to the public through the concentration of traffic on fewer main lines with attendant substantial savings in operating costs, or whether better service will accrue to the public through an extension of single line service with little or no reduction in cost and probably increased operating costs for the Midwest region as a whole.

In this brief, it will be shown that the Milwaukee, as a marginal predominently Midwestern railroad, has a significant interest in a combination of the Milwaukee and North Western (CM&NW) and in CM&NW obtaining control of Rock Island. It will be demonstrated that by combining these three major Midwestern railroads very substantial improvements in service within the Midwest as well as in connection with transcontinental and other interterritorial traffic will be achieved and with substantial reduction in cost of operations, all to the benefit of their railroad connections and the railroad industry in general.

It will also be established that a Union Pacific-Rock Island merger, no matter how it is conditioned, will not improve service to the public in any material way and may result in reduced service by all railroads in the aggregate. It will be pointed out that a Union Pacific-Rock

Island merger promises irresponsible waste of resources in an area where there are already too many railroads with attendant excessive social cost. It will also be shown that in fact such a merger produces no substantial reduction in operating costs and may increase operating costs for others so that the aggregate cost of service in the west will be increased, adding to the social cost of underutilization and overcapacity of the Midwestern railroads.

II.

EFFICIENCY IS THE PRIMARY PUBLIC INTEREST CRITERION FOR RAILROAD MERGERS.

Efficiency in the use of land, labor and capital within the railroad industry, as in any industry, should be the goal of economic regulation. This is recognized in the National Transportation Policy which enjoins the Commission, in applying the Act, "to promote safe, adequate, economical and efficient service and foster sound economic conditions in transportation and among the several carriers."

As Dr. Conant, author of "Railroad Mergers and Abandonments," stated in this case:

> "Two key aspects of efficiency in the economic organization of an industry are (1) the size or scale of firms in the industry, and (2) the long-run rate of utilization of existing plant capacity relative to the most economical feasible rate of utilization (chronic excess capacity)." (Milw. 671, p. 2)

Economies of scale occur when a business firm, by becoming larger in size, can invest in highly specialized capital equipment or plant, which comes only in very large minimal sizes, by which it can reduce cost. Railroads by their nature are large, highly specialized, single-use investments. A firm is of optimum size when its average costs of operation are lower than any other firm in the market area when measured by its investment in plant and other assets.

Nevertheless, it has never been reliably shown that average costs of railroads decrease with increased size because it cannot be assumed that any particular railroad company or combination of two or more, out of a large group of railroad companies, have the same utilization of land, labor and capital (production function). Consequently, in order to determine which railroad merger would produce the minimum average cost of operation, it is necessary to resort to comparisons of particular merger proposals (Milw. 671, p. 2).

Chronic excess capacity, the other key aspect of efficiency, is defined, technically, as "the difference between the output that a productive agent is capable of producing and the maximum output it is called on to produce." Chronic excess capacity will exist if there are more rail lines in an area than there is traffic to enable them to operate at reasonably near capacity (Milw. 671, p. 2).

The Rock Island lines between Chicago and Omaha, Kansas City and St. Louis, and Minneapolis and Kansas City are in much greater excess capacity railroad areas than its lines in Kansas, Nebraska or Colorado. The six parallel lines between Chicago and Omaha are clearly the outstanding example of excess capacity in this proceeding. They are the Burlington, the Illinois Central, the North Western, the Great Western (now merged with North Western),[3] the Rock Island and the Milwaukee.

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[3] Merger approved May 23, 1968, 333 ICC 236, and consummated July 1, 1968. Unless otherwise indicated, reference to North Western or CM&NW will include Great Western.

Two or three of these lines could easily handle all of the traffic formerly handled on all six, permitting maintenance savings by reducing the unneeded main lines to secondary lines (Milw. 671, p. 6).

There is no dispute about this. Mr. Robert A. Lovett, in this proceeding, made the following observation:

> "The fact, of course, is that in all probability either the North Western, the Milwaukee or the Rock Island line from Omaha-Council Bluffs to the Northern Illinois Gateways could handle all of the traffic between those points now handled by all three of them and by the Great Western as well. It would be uneconomic to maintain all four of them at the standards necessary to make them competitive for transcontinental traffic and to some extent at least parts of them will be downgraded if not abandoned completely if any of these carriers merge." (UP 1, p. 24)

The same could be said for the duplicate lines between Minneapolis and Chicago, Minneapolis and Kansas City and Chicago and Kansas City. If it would be uneconomic to keep all lines at competitive standards for transcontinental traffic between Omaha and Chicago as part of a four-way merged system, it is just as uneconomical from a public standpoint to operate them separately but competitively today.

Excess capacity in lines of railroad involves inefficiencies in terminals and use of other facilities as well. The idea has been expressed as overcapacity and underutilization and as unnecessary duplication of facilities and services.

Recent mergers approved by the Commission demonstrate that the greatest operating savings occur where formerly independent railroads overlap or parallel each other, which permit the elimination of duplicate facilities and lines and utilization of a combination of lines to produce the shortest, most level and expeditious routes.[4] Essentially end-to-end mergers produce very little opportunity for improved efficiency through reduction in excess capacity, consolidation of terminals or reduction in route miles.

The proposed Union Pacific-Rock Island merger has been described by witnesses for the proponents as well as opponents as an end-to-end merger (SP 26, p. 1; Milw. 671, p. 6). The CM&NW control of Rock Island, as a preliminary to merger, is primarily concerned with the substantial parallel or side by side features of their lines. The relative opportunities for improved efficiencies to the public and in internal operating costs will be discussed under later sections of this brief.

In an area of chronic excess capacity where the traffic volume of the railroads serving the area is relatively static and, for most, produce earnings which are inadequate, it is a misallocation of resources to invest funds in upgrading duplicate lines and terminals and duplicate equipment and services when a better use of funds could be found elsewhere. This results in higher than necessary rates or less than maximum service, or both. This is not only a waste of the railroad industry's resources, but also the nation's resources.

In commenting on this aspect of mergers involving the Midwestern lines, Dr. Conant had this to say:

> "One must conclude that the social cost of chronic excess capacity in railroads wastes the resources of

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[4] *Great Northern Pac. & B. Lines—Merger—Great Northern*, 328 I.C.C. 460, 331 I.C.C. 228, 331 I.C.C. 869, 333 I.C.C. 391; *Seaboard Air Line—Merger—Atlantic Coast Line*, 320 I.C.C. 122.

> the American economy in two aspects. Capital investment in misallocated resources is in the form of numerous parallel lines and duplicated terminals, car control and accounting systems. Many of the main lines and major terminals of these railroads have traffic density too light to make profitable the new and more intensive investment in automated technology which would lower long-run average costs. The misallocation is aggravated by the second waste of resources in higher operating costs of these railroads of less than optimum size for the particular markets in which they operate. As a result, more than an optimum number of trains of less than optimum size, operating on many lines at less than optimum speeds, increase their aggregate operating costs. Similar increased operating costs occur in uneconomic terminals and central offices. All merger proposals must be judged on their estimated success in reducing the social costs of excess capacity". (Milw. 671, pp. 5-6)

In an area of excess capacity, any proposal that promises to increase investment in fixed plant in order to increase capacity is obviously going in the wrong direction. This is what Union Pacific promises to do with Rock Island lines. It is no answer to say that inasmuch as a merged North Western-Milwaukee will reduce excess capacity, therefore a merged Union Pacific-Rock Island is justified in adding back new capacity where admittedly none is required. This is a gross misuse of funds and misallocation of resources about which more will be said later.

Diversions of traffic from other lines by merger is not in and of itself a criterion of whether a merger is good or bad. The Milwaukee believes that mergers which produce greater economies for the merging lines than diseconomies for other lines or that promise improvements in service that are not offset by reduction in service or higher costs for other lines are not necessarily contrary to the public interest. Likewise, proposed conditions which broaden the benefits of merger without reducing the opportunities for improved service or reduced costs of the merging lines and which produce benefits that are not offset by the injury done to other lines are not unreasonable (Milw. 657, pp. 7-8). Where the opposite occurs, then the railroads in the aggregate are injured by merger and an increased social cost is incurred which must be borne by the public one way or another.

Furthermore, mergers which have as their primary purpose diversions of traffic from other lines of such magnitude as to create a marked imbalance of earning power among the competing lines run contrary to the public interest in maintaining regional and interritorial rates at the lowest level commensurate with service requirements. This is especially true where the Commission cannot reallocate revenues on interline traffic through adjustment in divisions because the inbalance is between competing railroads in the same territory.

III.

CONTROL AND SUBSEQUENT MERGER OF ROCK ISLAND WITH A MERGED MILWAUKEE-NORTH WESTERN (CM&NW) SHOULD BE APPROVED BECAUSE IT MEETS THE PRIMARY CRITERION OF PROMOTING EFFICIENCY BY PROVIDING A SOLUTION TO THE CHRONIC RAILROAD PROBLEM OF OVERCAPACITY AND UNDER UTILIZATION IN THE MIDWEST.

A. The Milwaukee, Plagued With Excess Capacity, Cannot Overcome Its Marginal Status As An Independent Railroad.

The Milwaukee has been characterized as a marginal Midwestern railroad. After emerging from receivership in 1927 with optimistic reports for its future (131 I.C.C. 673, 138 I.C.C. 291, 154 I.C.C. 586), the Milwaukee was plunged into bankruptcy in 1935, from which it emerged a decade later. For the better part of a whole generation since the end of World War II, the Milwaukee has had and continues to have inadequate earnings by any standard. Among the factors which contribute to the Milwaukee's inability to produce sufficient net income are: (1) It has a long transcontinental line but it is not primarily a transcontinental carrier in that its line to the Pacific Coast has very low density and as a system it is a light density railroad; (2) It is principally a Midwestern carrier with numerous branches and secondary lines, relatively short average hauls and a high proportion of origination and termination costs; and (3) It has a high ratio of debt to equity (Milw. 659, p. 1).

The Milwaukee management has for several years followed an aggressive policy of cost cutting while at the same time employing the newest means and devices for improving its traffic horizons.

It has reduced or eliminated little-used passenger service, thereby reducing its passenger deficit and passenger train operating ratio (Milw. 659, p. 3, App. RFK-6). It has rearranged agency service at smaller stations, mechanized maintenance of way and repair operations, installed inventory controls and the latest computer equipment, equipped large segments of its lines with centralized traffic control, consolidated and modernized heavy freight car and diesel repair facilities, installed three large and modern electrically controlled gravity retarder freight classification yards at major terminals, all at substantial capital expenditures (Milw. 657, p. 3).

These capital improvement programs, cost cutting programs, mechanization of operations and other activities have produced substantial reduction in expenditures for railway maintenance and equipment maintenance. They have been largely responsible for the reduction in employment on the Milwaukee from 27,936 employees in 1955 to 16,470 in 1966. Nevertheless, compensation paid to employees has risen at a faster rate, so that total compensation paid to employees has remained almost the same throughout the twelve-year period. By careful planning and close supervision of expenses, the Milwaukee has been able to maintain a relatively low freight operating ratio; 73.53% in 1966 (Milw. 659, App. RFK-6). Wages have increased at a faster rate than capital investment and new methods can offset.

Forecasts of record for the full year 1967 show that new wage and employee benefit costs and new increases in Railroad Retirement and Medicare costs for the Milwaukee would total $8.1 million (Milw. 657, p. 6).

The Milwaukee, like other railroads, as its resources have permitted, has acquired the latest in diesel power and specialized cars to continue to supply the equipment to satisfy the requirements of its customers and remain competitive with its competitors engaged in all forms of transportation.

During the period 1961-1966, the Milwaukee acquired 88 new diesel locomotive units, 2,837 new freight train cars and 62 new suburban passenger train cars at a cost of $68,125,012. In addition, during this same period, it acquired 8,442 rebuilt freight train cars at a cost of $27,642,936. Aggregate acquisitions during this six-year period totaled $95.8 million. For the twelve-year period 1955 to 1966, inclusive, the Milwaukee investment in new equipment totaled $207.4 million (Milw. 657, p. 5).

Despite this heavy expenditure for equipment, the Milwaukee's revenue freight car ownership declined 30 per cent in the twelve-year period, although the average age improved from 20.3 years to 17.8 years. Its number of locomotives units over the same time period remained approximately the same, although horsepower per unit has improved to meet new demands for increased speed and dependability (Milw. 657, p. 5).

All of these capital expenditures and improvements have taxed the financial ability of the Milwaukee to continue its transportation service to the public. To demonstrate this drain on its financial resources, Mr. C. E. Crippen, President of the Milwaukee, offered as an appendix to his testimony a statement showing the source and application of funds of the Milwaukee over the twelve years, 1955-1966 (Milw. 657, App. CEC-4).

This source and application of funds statement shows that all sources of funds (net income, depreciation charges and similar non-fund charges, sales of property, salvage, miscellaneous sources and equipment borrowings provided $488,920,920 for the twelve-year period. However, the application of funds for expenditures, including a modest $61,807,260[5] in dividends to preferred and common stockholders, amounted to $512,661,356, or $23,740,436 more than total funds provided (Milw. 657, p. 4).

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[5] The dividends paid to stockholders is modest indeed when it is noted that in three of the twelve years no dividend was paid to the common stockholders (Milw. 657, App. CEC-4).

As a result, working capital fell from a balance of \$39,041,617 at the beginning of the period to \$15,301,182 at the close of 1966. In 1960, working capital was reduced to only \$9.5 million. During this twelve-year period borrowing for equipment exceeded principal payments on equipment debt by \$35.7 million. Without this added source of cash and a \$10.9 million gain on sales of property, the Milwaukee's working capital would have been either negative or negligible by the end of 1966 (Milw. 657, pp. 4-5).

The Milwaukee's working capital position is precariously low. The \$15.3 million at the end of 1966 is before subtracting principal payments on equipment debt due within one year, for 1967 estimated to be \$15.2 million. With this in mind and considering the fact that cash operating expenses average about \$15 million per month for the Milwaukee, the urgency of maintaining and improving revenues is abundantly clear (Milw. 659, pp. 2-3).

While the Milwaukee's operating revenues have ranged from \$222 million in 1961 to \$254 million in 1956 and 1957, its net income has ranged from \$9.5 million in 1955 to a low of \$1.3 million in 1960. For the entire twelve-year period, the Milwaukee's annual net income has averaged only \$6.3 million (Milw. 657, p. 6).

One of the factors contributing to this low average annual net income is its high ratio of long-term debt to stockholders equity. For example, in 1966 the Milwaukee had \$53.3 million net revenue from railway operations. After taxes and rents, this was reduced to \$16.3 million net railway operating income. To this was added other income to bring the Milwaukee's net income before fixed charges to \$20.4 million; however, after fixed and contingent interest on long-term debt, net income was only $8.1 million. As Mr. R. F. Kratochwill, the Milwaukee's Vice President-Finance and Accounting stated:

> "This railroad cannot withstand any major and continuing loss of revenues, in my opinion. . . . Even with a good freight operating ratio, the railroad has not been able to bring adequate monies to net income after taxes, rents and debt charges." (Milw. 659, p. 3)

For most of the twelve-year period mentioned, the Milwaukee has paid no Federal income taxes notwithstanding the showing of net income each year. The major factor contributing to this no-tax status has been the election of depreciation acceleration for tax purposes. This election merely postpones the taxes until future years and is in effect borrowing on future earnings (Milw. 659, p. 2). The Company's tax payments and tax loss carry-forward position of the Milwaukee are set forth in Milw. 659, App. RFK-8, as amended, at page 34277 of the transcript.

From the foregoing, it is clear that the Milwaukee management must seek and continue to seek new and more efficient means of maintaining its operating ratio at the lowest possible level commensurate with adequate service and safety requirements simply to retain its present marginal financial position in the face of ever increasing wage and material and supply costs.

The Milwaukee has exploited every avenue for maintaining and, hopefully, increasing its revenues.

The Milwaukee operates two scheduled transcontinental trains daily in each direction between Chicago and Seattle-Tacoma via Twin Cities. One of these trains operates in each direction on the fastest schedule of any line to the North Pacific Coast. It also operates additional scheduled trains between Chicago and Twin Cities, including a brace of all piggyback trains, on a fast nine-hour schedule (Milw 658, p. 3).

It also operates three sets of trains daily between Chicago and Council Bluffs, one set of which moves intact, preblocked for direct connection between the Milwaukee and the Union Pacific at Council Bluffs providing a fast schedule for fourth morning delivery westbound at Pacific Coast terminals and a fast eastbound schedule providing fifth morning delivery at Chicago or to eastern lines at Chicago (Milw. 691, pp. 1-6; Milw. 658, pp. 12-13).

The Milwaukee has been very active in developing bi-level and tri-level automobile traffic and in expanding TOFC traffic, together with facilities for handling this traffic. These sources of traffic have shown substantial growth on the Milwaukee in recent years. For example, its piggy-back traffic has grown from 21,305 trailer loads handled in 1962, with revenues of $2,057,170, to 52,109 trailer loads in 1966, producing revenues of $10,932,721 (Milw. 658, p. 2).

The Milwaukee maintains a relatively modern car fleet with a variety of special purpose cars to meet the requirements of its shippers.

The Milwaukee has installed modern methods and equipment, including third generation computers, to keep track of its equipment in order to obtain maximum utilization of its car fleet and in order to trace and expedite carload shipments. Information regarding car movements is gathered at a centralized location and immediately made available to its sales offices all over the country (Milw. 658, p. 4).

The Milwaukee has an active Industrial Department which locates an average of 125 industries along its lines annually. It has and continues to acquire land for industrial development and has developed and is in the process of developing a number of important industrial parks for industry location (Milw. 658, pp. 4-5).

The Milwaukee has engaged in modern pricing practices for rail services. It has a competent market and cost research department and where added earnings can be obtained it has published tariffs for handling multiple car shipments of grain and coal (Milw. 658, pp. 2-6).

The Milwaukee has an active sales force with regional and subsidiary offices and agencies throughout the country. No one can seriously challenge the fact that the Milwaukee has an aggressive pricing and sales program (Milw. 658, p. 13).

Despite the efforts made to improve the freight revenues and traffic volume of the Milwaukee, over-all results show more or less static revenues and revenue ton miles for the system. And this is typical of predominantly Upper Midwest roads. Total tons and ton miles of revenue freight handled by the Milwaukee compared with that handled by the North Western, Great Western, Burlington and Rock Island, and with Great Northern, Northern Pacific, SP&S, Union Pacific, Southern Pacific and Santa Fe for the twenty-year period, 1947 through 1966, shows that tons and ton miles handled by the Union Pacific, Southern Pacific and Santa Fe have increased substantially over the years, whereas the Midwest roads, the Milwaukee, North Western, Great Western, Rock Island and even Burlington have remained relatively static. Freight revenues have generally paralleled ton miles since 1958, the year the last important freight rate increase became effective during this period of years (Milw. 658, p. 6).

Although the Milwaukee has a main line extending 2188 miles from Chicago to Tacoma, Washington, its average length of haul was only 364.30 miles in 1966. The North Western and Great Western average hauls were even shorter. This can be compared with average hauls on the Union Pacific of 615.22 miles and Southern Pacific of 500.26 miles (Milw. 658, App. GHK-3).

The explanation for the relatively short hauls on these predominantly Midwestern roads is that the territory these granger lines serve produces grain and other agricultural products which move predominently east and south of their lines via Chicago, Kansas City and St. Louis where they go off line. The industrial urban centers along the Mississippi and in southern Wisconsin and in Illinois and Iowa, such as Twin Cities, Quad Cities, Des Moines, Omaha, Kansas City, Milwaukee and Chicago, which are served by the Milwaukee and other Midwest railroads, ship to all parts of the country, but distribution within the Midwest is done largely by truck and a large part of their raw material can be received by barge or lake vessels. Here again, however, the major markets available through use of rail service result in short hauls to the eastern gateways of Chicago, Peoria and St. Louis or western gateways of Kansas City, Twin Cities and Council Bluffs and related points of interchange with the transcontinental lines (Milw. 658, pp. 6-7). The effect of this situation is that of all traffic originated or terminated, or both, on the lines of the Milwaukee in the Midwestern states of Indiana, Illinois, Wisconsin, Iowa and Minnesota, less than half of the freight charges accrue to the Milwaukee (Milw. 658, App. GHK-4). The data from which this percentage arises excludes overhead traffic and duplicates revenue from local traffic and therefore the proportion of the revenues retained is overstated because line haul revenues from local traffic are retained 100 per cent (Milw. 658, p. 7).

The Milwaukee originates or terminates, or both, over 90 per cent of the carloads it handles. In 1966, 62.5 per cent of all carloads handled, accounted for 65.8 per cent of its revenues originated on its lines. About half of this was local traffic. Interline terminated traffic constituted 28.4 per cent of all carloads handled, producing 24.9 per cent of its revenues. Less than 10 per cent of its total carloads handled was overhead. The North Western is likewise a heavy originator and terminator of freight traffic with only 14.69 per cent of its carloads overhead. This may be compared with 25.67 per cent overhead for Union Pacific and 22.93 per cent for Burlington (Milw.. 658, App. GHK-2).

This heavy burden of originating and terminating traffic is not only a service that the Milwaukee and North Western each performs for itself, but for every other railroad in the country, although the benefits of this service abound in greater degree to its more important connections. The combination of short average hauls and heavy origination and termination expense is an important factor influencing the marginal status of the Milwaukee and North Western. To illustrate the relative expense incurred by various roads, the Milwaukee prepared an exhibit comparing yard crew wages with road crew wages on several western railroads. It shows that for the Milwaukee, North Western and Great Western, the yard wages were 84.58, 96.18 and 84.57 per cent, respectively, of road crew wages; whereas, for the Union Pacific, Southern Pacific, Santa Fe and D&RGW, they were 55.02, 53.25, 57.06 and 60.20 per cent, respectively (Milw. 657, App. CEC-3).

It should be remembered that with a larger share of carload originations and terminations involving car days in terminals, car hire costs in relation to revenues are likewise greater. This has been illustrated by comparisons of car miles per car day (CNW 648, pp. 187-188; CNW 649, App. IRB 16.3).

The foregoing demonstrates that the Milwaukee, confined as it is to the geographical area it serves, has no opportunity to improve its precariously marginal status without dramatic new sources of revenue or a drastic reduction in operating costs or debt or some combination of all three. As an independent company none of these can be accomplished. Careful planning to take advantage of every new technique in the art of railroading and aggressive action designed to broaden its traffic base have merely maintained an undulating but nevertheless static traffic volume and revenues and dangerously inadequate earnings.

Nothing has happened since 1966, the last full year for which data were available at the time the Milwaukee presented its testimony in this proceedings, which would indicate any change of this situation, now or in the foreseeable future, except events depending upon current merger proceedings involving railroads operating in the region served by the Milwaukee.

While it is true that as the result of the *Transcontinental Divisions* case[6] the Milwaukee has now received approximately $14 million from increased divisions, including interest, retroactive to 1963, thus improving its working capital position, this does not overcome the basic problem or even account for the previ-

[6] *Akron, Canton & Youngstown R. Co.* v. *A,T&SF, Ry. Co.* Dkt. No. 31503, 321 I.C.C. 17, 322 I.C.C. 491.

ously mentioned $35.7 million in borrowed funds reflected in its working capital position at the end of 1966. Increased divisions from transcontinental traffic for the future should improve the Milwaukee's net by $2.8 million in 1967 and under $3 million annually for later years, based upon current traffic volume and consist (T. 34125-26). However, this by no means produces an adequate net income. The results for 1967, adjusted to eliminate retroactive divisions received show a net income for the Milwaukee of $2,733,925 (CNW 1218, App. 10).

It is also true that since the end of 1966, the Milwaukee has made further reductions in passenger service following the loss of mail moving on passenger trains.[7] This should somewhat reduce its passenger train deficit, but by no means does it spell out any substantial improvement in net earnings. Part of the passenger train deficit results from allocation of common expense between freight and passenger service, and with increased freight train speeds and heavier loading these allocations will probably be absorbed by freight service (T. 34120-22). Where direct or above the rail costs have exceeded revenues from passenger service, the Milwaukee has for years aggressively sought elimination of such trains, with considerable success, and this is the case with respect to recent discontinuances due to loss of mail revenue. Recent history shows that internal cost cutting steps in this field, together with similar steps taken in all other fields of railroading, have been eventually offset by increased wages and costs of supplies and new equipment.

On cross-examination of Mr. Crippen by the Union Pacific counsel, it was pointed out that in December of 1966 the so-called full crew law was repealed in the State

[7] See joint brief, p. 233, footnote.

of Washington and that court action was progressing in Wisconsin toward the same end, with expected long-term wage cost reductions (T. 32128-30). However, any hope for what in this case must be considered localized relief for the Milwaukee and other railroads operating in these states has been dimmed, if not dashed altogether, so far as the fireman issue is concerned, by the recent decision of the Circuit Court of Appeals for the District of Columbia in *B.R.T.* v. *Akron & B.B. R. Co.* 1967, 385 F.2d 581, interpreting the effect of the award of Arbitration Board 282 under Public Law 88, 87th Congress, and by the even more recent decision of the Supreme Court in the Arkansas full crew case, *Brotherhood of Locomotive Firemen & Enginemen* v. *Chicago, Rock Island & P. R. Co.* (1968), ... U.S. ...., 37 LW4032.

This last point is not important from the overall aspects of this case but simply serves to emphasize the error of counting chickens before they are hatched and proves that historical general trends and the general common experience of those familiar with their particular fields are more reliable in predicting overall financial results for particular railroads than isolated and independent developments expected to take place in the future but about which there has been no experience as to the total effect.

Aside from general rate increases which generally tend only to hold the line against rising wages and material and supply costs, not otherwise provided for by technological advances, the one realistic path to improved earnings and opportunities for better service to the public for marginal railroads such as the Milwaukee is through merger. Without merger the Milwaukee is condemned to a hand-to-mouth existence.

Frequent mention has been made on the record in these proceedings of the so-called Milwaukee Conditions in the *Northern Lines* case, *Great Northern Pacific & Burlington Lines, Inc., supra,* Appendix L, Conditions 20 to 25, with particular emphasis upon their ability to improve the Milwaukee and CM&NW's net earnings.[8]

The Milwaukee's estimates, made in that case, indicated that the Milwaukee, upon consummation of that merger with Milwaukee Conditions, would obtain a net increase in earnings of about $3 million dollars (T. 34141).

A modest improvement in net earnings when added to an average annual net income of only $6 million over a twelve-year period is indeed welcome to the Milwaukee, but it does not improve net earnings in the magnitude required to assure that it can and will be more than a relatively marginal railroad operating not only in the far West but also in the Midwest. A Union Pacific-Rock Island merger when added to the competition of the Burlington-Northern would seriously impair if not delete the benefits expected by the Milwaukee from its conditions in the *Northern Lines* case.

B. The Efficiencies Of A Milwaukee-North Western Merger Should Not Be Used To Justify A Union Pacific-Rock Island Merger.

The Milwaukee has long sought merger with North Western and Rock Island and now seeks ultimate merger with Rock Island through CM&NW (Milw. 657, pp. 9-10).

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[8] This report and order of the Commission was affirmed by a statutory Three-Judge District Court for the District of Columbia, November 20, 1968, in *United States* v. *I.C.C.*, Civil No. 1132, 68.

Studies were made of a Milwaukee-North Western merger in 1955. The CM&NW has now been agreed upon and its approval is pending before the Commission in Finance Docket No. 24182.[9] No purpose would be served by reviewing the benefits of that merger in this case. The proposed CM&NW promises, however, to improve service within the Midwest and to produce a substantial savings from the elimination of duplicate facilities and services and to reduce excess capacity. The total benefits of this merger, including Great Western, based on 1964 data, are expected to reach $38.9 million before income taxes. Even with a pro forma pre tax net income of $56.7 million for 1965 (UP 1231), this does not put CM&NW in a class with Union Pacific, Southern Pacific, Santa Fe or the new Burlington-Northern when measured by tons handled or size of plant. For the year 1967 net income of CM&NW after merger benefits is only $41.7 million (CNW 1218, App. 10).

A merger of Rock Island into Union Pacific would be a crippling blow to the CM&NW and disastrous should the Milwaukee and North Western not merge (Joint brief, pp. 249-50; 275). While this is reason enough for opposing Union Pacific and supporting, as an alternative, consolidation of Rock Island with CM&NW, it is by no means the only reason.[10]

To show the relative territory served by the Milwaukee's principal lines in comparison with those of Rock Island, Southern Pacific and Union Pacific separately and in comparison with a merged Union Pacific-

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[9] Sometimes referred to as the "*Milwaukee* case." The Examiners Report, issued December 16, 1968, recommended approval of this merger with certain conditions.

[10] CM&NW control of Rock Island would produce added benefits for CM&NW and Rock Island of over $21.4 million (CNW 1215, p. 11).

Rock Island (North) including territory covered by Condition E in the *Central Pacific* case,[11] and with the proposed new Burlington-Northern, the Milwaukee introduced two maps[12] (Milw. 657, App. CEC 8-9).

In conjunction with these maps, a density map was prepared and for ready reference it is annexed to this brief as an Appendix. This density map shows the relative tonnage handled over the Milwaukee's lines west of Twin Cities, compared with other transcontinental lines. This shows that the Union Pacific generates from the broad territory its lines serves over eight times more tonnage between Granger and the Missouri River and almost three times more tonnage between Granger and Portland than does the Milwaukee lines west of Mobridge, South Dakota located on the Missouri River. The Great Northern and Northern Pacific combined haul about the same tonnage as do either Southern Pacific and Santa Fe, which is over five times greater than is hauled over the Milwaukee lines (Milw. 657, App. CEC-7).

This density chart, does not reflect traffic gained or lost from mergers, demonstrates the limited ability of the Milwaukee's lines west to generate traffic with which to support its extensive Midwest operations or those of CM&NW. Consequently, the Milwaukee or the CM&NW, is and will be dependent upon (1) traffic moving within the Midwest, which is highly susceptible to competition from other modes, and (2) upon interterritorial traffic, particularly transcontinental traffic, interchanged with other lines.

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[11] *Control, Central Pacific by Southern Pacific,* F.D. No. 2613, 76 I.C.C. 508, 317 I.C.C. 469, 328 I.C.C., 345.

[12] The addition of North Western's non-duplicating main lines to this map would not materially change the Milwaukee territory except to add a line from Chicago area to St. Louis and a direct line from Minneapolis to Omaha.

Moreover, the intrusion of a powerful Union Pacific into the Midwest would further upset the competitive balance in the Midwest even with a merged Milwaukee-North Western.

To illustrate the relative economic status and earning power of the proposed competitors of the Milwaukee and of CM&NW, the Milwaukee presented a series of bar charts showing revenue tons, revenue ton miles, freight revenues, net railway operating income and net income of the Burlington-Northern (GNP&B), Southern Pacific with Rock Island south, (SP-RI(S)) Union Pacific with Rock Island north (UP-RI(N)) and CM&NW (including CGW) for each of twenty years ending in 1966 (Milw. 657, App. CEC-11). These charts do not reflect benefits of merger, but are simply the starting point. The net income chart should be changed to reduce net income for GNP&B by $12 million for each year to account for intercompany dividends (T. 43111-12).[13]

From this it will be seen that CM&NW has always handled more tonnage than a UP-RI (N) and prior to 1956 as much or more than SP-RI (S), but the spread has narrowed as between CM&NW and UP-RI (N) and has reversed as between CM&NW and SP-RI (S). With respect to revenue ton miles, it will be seen that CM&NW has undulated on about the same plane but all other com-

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[13] The charts do not reflect North Western's dividend income from non-transportation subsidiaries to the combined net income of CM&NW or in the alternative eliminate Union Pacific's income from non-transportation activities of the transportation company (T. 34162-66). The exhibit includes non-transportation income as reported to the I.C.C. for all combinations shown. Aside from the fact they likewise do not show Union Pacific or other lines dividend income, this suggestion would require re-computing income taxes for all combinations shown which is peculiarly within their own knowledge.

binations shown have increased with the SP-RI (S) increasing most dramatically.

As will be seen from the next chart, freight revenues have followed ton miles for each combination. The great difference in operating results shows up, however, in net railway operating income and net income shown on the next two sheets. Net railway operating income has increased for all combinations since the low point in 1960, but not in the meaningful way for CM&NW as it has for the other combinations. In 1966 the net railway operating income for all of the other combinations was better than for CM&NW by a ratio of over 8 to 3. This shows the great need for reducing operating costs on the CM&NW.

The disparity is even more striking when the net income of the several combinations are compared on the last chart. In 1966 the ratio of UP-RI (N) net income was 6 to 1 over CM&NW, even though Rock Island was not enjoying a net income year. The other combinations were in the same class as UP-RI (N).

These disparities in earning power of the respective combinations shown clearly demonstrate the need for neither adding to the financial inequality of CM&NW nor denying to CM&NW of the benefit of further operating cost reductions that Rock Island could bring to CM&NW and Rock Island. Assuming that each of these combinations could add merger benefits in the neighborhood of $40 to $50 million in net railway operating income, before income taxes, through either operating savings or traffic diversions, or both, the relative imbalance in financial resources as between CM&NW and the other combinations is not improved, particularly when CM&NW is expected to contribute $15.1 million net from its merger benefits to UP-RI (N) (CNW 1025, p. 8).

Adding Rock Island to CM&NW would not increase tons handled, ton miles or freight revenues of the combination in any important degree over what they handle separately. Furthermore, it would not reduce those of Union Pacific, Southern Pacific or Burlington-Northern or any other line materially. However it would make a very substantial increase in net railway operating income and net income for CM&NW and Rock Island. According to North Western's four-way study, a combination of Milwaukee, North Western and Rock Island would increase their combined net earnings by $62.3 million annually over what they now earn independently (CNW 1218, App. 10). Related to size of plant and tons of freight handled, this would only begin to establish a more realistic balance of financial resources among the large western lines.

By way of comparison, adding Rock Island to Union Pacific and Southern Pacific would be expected to add more tons, ton miles and freight revenues to those combinations, over what they now handle separately, through substantial diversion of rail traffic, but this would not improve net railway operating income as much in relation to increased revenue tons, ton miles or freight revenues because there would be no significant source of savings in operating costs. To the extent that a Union Pacific-Rock Island merger diverts traffic from a CM&-NW, it adds it to the volume handled by Union Pacific or Southern Pacific where it is needed least.

Undoubtedly, Rock Island should participate in a move to improve its share of available railroad earnings and to improve railroad service to its patrons and the territory it serves, but not at the expense of the marginal Milwaukee or a CM&NW and for the aggrandizement of Union Pacific and Southern Pacific. For these reasons, the Milwaukee adamantly opposes the Union Pacific proposal and vigorously supports CM&NW control of Rock Island and its ultimate merger with CM&NW. None of these three large independent railroads can afford to be left out and none can afford not to include the other two. Neither can the public.

C. The Rock Island As A Marginal Midwestern Railroad Should Be Included With CM&NW To Promote Greater Efficiency.

The Rock Island's present relative financial position is an anomaly in some respects. Its lines of railroad are strategically located north and south and east and west across the heart land of America, which Rock Island calls "Rock Island Country" (RI 19, JL-2). Roughly, its principal lines resemble the spokes of two intermeshing wheels. With Kansas City as one hub it has lines radiating east to St. Louis, southeast to Alexandria, Louisiana, south to Dallas, Forth Worth and Houston, southwest to Tucumcari, New Mexico, west to Denver, north to Des Moines, Iowa, and northeast to Chicago. Des Moines is another hub. Rock Island lines extend from Des Moines west to Omaha and on to Denver, northwest to Sioux Falls, north to Twin Cities, east to Chicago, southeast to Keokuk, and then again the line runs south connecting with its Kansas City hub. It can and does participate in all major routes and channels of trade between the Upper Midwest and the Great Lakes on the one hand, and the Gulf of Mexico on the other, between the Southeast and the Northwest, between the East and the Southwest and between the East and the Midwest and between the Midwest and the East on the one hand, and Mountain Pacific states on the other.

With its strategic location and other more favorable circumstances it should be somewhat better off financially than its current deficit earnings would indicate. It does not have an unusually heavy burden of originating and terminating traffic. It has long average hauls for a Midwest railroad and while its revenue per mile of road is low, they are better than those of either the Milwaukee or the North Western.

The Rock Island has proportionately fewer originations or terminations on its lines than either the Milwaukee or North Western. Its overhead traffic constituted 24.16 per cent of its total carload business, almost as much as Union Pacific's 25.67 per cent. Compare this with 9.11 per cent for Milwaukee and 14.69 per cent for North Western (Milw. 658, App. GHK-2). Its percentage of yard crew wages to train crew wages is 74.27 per cent compared with 84.58 per cent for the Milwaukee and 96.18 per cent for the North Western (Milw. 657, App. CEC-3).

The Rock Island's average length of haul is 403.75 miles, compared with 364.30 and 261.39 for the Milwaukee and the North Western, respectively (Milw. 658, App. GHK-3). The importance of the length of haul increases with the proportion of originations and terminations on line because the longer the haul the more revenue there is from any particular consist of traffic over which to spread origination and termination costs, including costs in terminals as well as way train and branch line service. For this reason extending bridge hauls at the expense of the originating or terminating carriers is going the wrong way.

The Rock Island system average revenue per mile of road is substantially more than either Milwaukee or North Western. In 1964 Rock Island had revenue per mile of road of $22,057, midway between the Burlington with $25,630 and the Milwaukee and North Western with $18,011 and $18,568, respectively (RI 19, JL-3, Rev.).

Despite its somewhat more favorable inherent advantages over the Milwaukee and North Western, Rock Island's net income has taken a long down hill slide since 1959, hitting the bottom in 1967 with a net deficit of over $16 million. It is admitted that at least part of its recent problems stem from past managerial mistakes. It has been over-dividended in the past (T. 292). Accordingly, it has not made use of its funds when they were available to make urgent capital expenditures so as to take timely advantage of the latest technological advances in railroad methods and operations. It admits that not only did it allow its cars, engines and other equipment to become obsolete and in bad order, but that its operating practices themselves were archaic (T. 9819-20; 9823-24; 9898-99; 10138; 10247-48).

But its estimates of future funds needed to bring it up to standards required to handle Rock Island's normal traffic requirements are somewhat exaggerated.

Its projections of future car requirements, for example, were predicated on the theory that its car requirements should be related to its ton miles so that it would contribute to the national car fleet on the basis of service units performed (T. 10838-39). This is a theory only and simply is not practical because a heavy overhead and terminating carrier would not find on-line loads for its on-line foreign and company owned cars. Apparently Rock Island had in mind making money as a car owner rather than a user (CNW CX-63; T. 10845-95). No railroad, including the wealthy Union Pacific, purchases cars on this basis (T. 974; 976-7; 999; 2272; 10870-71; 10885). It also inflated its fund requirements for cars by basing its projections of cash needed on a change from long term equipment leasing to conventional financing. This results in uneconomic use of urgently needed cash for other capital purposes (Milw. 659, pp. 4-6).[14]

It has been claimed that if Rock Island could increase its car fleet it could get more tonnage over its lines, and doubtless this would be true if none of its competitors were able to match that increased car fleet (UP 4-D, pp. 5, 6, 11). Rock Island introduced an exhibit in support of this contention showing points throughout the United States where Rock Island could have obtained a haul if it had had a car or cars available for loading at particular points on particular days (RI 23, p. 9, AFH 9; T. 11787-89). In all probability, some other railroad supplied the car for that particular movement. But, Rock Island has no control over its general purpose cars when off-line. A substantial number of claimed car shortages were in this category. The carrier having possession of such cars has discretion as to which cars are placed where, subject to the AAR car service rules. With respect to specialized cars not subject to the AAR rules, but subject to directions of the owning line, improvement in the available number of specialized cars off line over those owned by its competitors would put more traffic over Rock Island (CNW CX 20; Milw. CX 2). This result does not require the acquisition of more cars if the cars of a connecting road, such as Union Pacific, can be made available for movement over Rock Island lines through cooperation in better schedules, as now has been done in connection with both Union Pacific and Southern Pacific (UP 1053, p. 1; T. 2452-53; 24282-89).

Much of the funds Rock Island claims it needs for

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[14] See "University of Illinois Law Forum," Volume 1962, Spring, No. 1, pp. 33 et seq.

roadway are for ordinary maintenance items and not capital improvements (T. 10329; 10332-34; 10337-38). But Rock Island's principal lines are not in as bad shape as Union Pacific would have the examiners and the Commission think when normal Rock Island traffic volume is considered (UP 13A, pp. 3-4). New rail and tie replacement are primarily related to use, i.e., tonnage over the track (Milw. 629, p. 2). New rail is laid in main lines on cycle over a long period of years. Used rail, replaced by new rail in main lines, is used over again in secondary and branch lines and before it is finally scrapped it may be used in yard and switching tracks. This long term cycling period, tonnage over the rail, and weight of rail used are interrelated. Any year or period of years less than the full cycle must be normalized to the full cycle period for the particular railroad to determine annual requirements. When a comparison is made on the basis of a normalized year and recognizing differences in their respective traffic volume (tonnage), Rock Island, during the period 1958-1964, laid 37 per cent of its normalized requirements whereas Union Pacific during the same period laid 45 per cent of its normalized requirements. This does not reflect what Union Pacific claimed was the relative condition of the Rock Island (Milw. 629; Milw. CX-5; UP 13, p. 2; T. 792; 795).

Tie replacement is also governed by the same factors. Using a ten year period, 1955-1964, and giving effect to differences in tonnage handled, Rock Island during this period was 36 ties short of its normalized requirements and so was the well maintained Union Pacific (Milw. 629; Milw. CX-6).

Despite what might be considered exaggerated claims as to the condition of the Rock Island, and despite the fact that present Rock Island management has corrected and is correcting many of the practices and mistakes of previous years, it is not contended by anyone that Rock Island, as an independent company, can be much more than a marginal railroad with low earnings. Nevertheless, the current earnings crisis on the Rock Island should not stampede anyone into erroneous conclusions or glossing over the fundamental issues of this case. Rock Island, unlike the Milwaukee, is not a high debt company. As Mr. Jenks, president of the Missouri Pacific and formerly president of Rock Island, pointed out, the Rock Island is practically bankrupt-proof (T. 43111-12).

The Rock Island ascribes its problems to (1) an over supply of railroad facilities in Rock Island territory and (2) its inherently weak position as a competitor in its own territory (RI 19, pp. 5-8). The Milwaukee does not disagree with these conclusions, but it heartily disagrees with Rock Island's preferred solution, i.e., merger with the wealthy Union Pacific.

To support its conclusion that there is an over supply of railroad facilities in "Rock Island Country," the Rock Island points to the fact that of 7,776 miles of railroad, almost 35 per cent were located in Illinois, Iowa, Minnesota and South Dakota, with 26.4 per cent in Iowa alone (RI 19, p. 5). This is also Milwaukee, Great Western and North Western territory as well as that of Burlington, Illinois Central and Norfolk & Western. Outside of Illinois, where it has heavy density over 294 miles of railroad, its greatest revenue per mile of road is from Rock Island lines in Kansas ($35,421), Missouri ($23,944), and New Mexico ($23,181). In Iowa, Minnesota and South Dakota its revenue per mile of road was $17,483, $14,386 and $548, respectively, far below Rock Island's system average of $22,057 (RI 19, p. 8 Rev.). Obviously Rock Island's problem of too many railroad facilities and too light revenues arises in the latter named states also served by CM&NW.

The Rock Island also attempted to explain by various economic indicators why there was not sufficient business for all of the lines in "Rock Island Country" (RI 19, p. 6). These statistical comparisons are not meaningful, because when applied to other railroads serving the same states or applied to carriers serving other states with very favorable economic indicators, the results prove nothing (Milw. CX-8; T. 10140-45).

The once profitable Midwest railroads, because of (1) changes in traffic patterns and distribution practices of industry, (2) incursions into formerly captive railroad traffic by other transportation modes, particularly in the field of finished and semi-finished manufactured articles, giving trucks special logistics advantages on shorter hauls, and on important longer haul bulk movements, the advantages of movement by barge, and (3) the ever increasing capacity of the railroads, due to improvements in the art, are simply providing too many duplicating services and investing over and over again in too much inadequately used plant. Rock Island's evidence does not disagree with this.

In support of Rock Island's conclusion that it is inherently weak as a competitor in its own territory, it is claimed that this is due to a lack of a sufficient proportion of local traffic (RI 19, pp. 8 Rev.-9). Both the Milwaukee and North Western generate a fair share of local traffic. Of all carloads handled by the Milwaukee and the North Western, 31.46 and 29.51 per cent was local business, compared with 28.06 per cent for Rock Island and 28.66 per cent for Union Pacific. If this traffic mix is any explanation of Rock Island's problem, then its solution lies in combining the Rock Island with a merged Milwaukee-North Western. Together the Milwaukee and North Western (including Great Western) handled 841,219 carloads of local business in 1966, compared with 460,327 for Union Pacific. CM&NW both relatively and absolutely could add a greater proportion of local traffic in combination with Rock Island than could a combination of Union Pacific and Rock Island (Milw. 658, App. GHK-2).

Rock Island also contends that its routes between principal terminals and trade centers are generally longer than those of its competitors and, hence, it is at competitive disadvantage on interline traffic (RI 19, pp. 11 Rev.-12 Rev.-13).[15] If Rock Island's aim is to improve its route structure it should prefer joining with CM&NW rather than Union Pacific. Merging with Union Pacific, with or without sale of the south half to Southern Pacific, would not change route mileages via Rock Island lines in any significant degree. By combining Rock Island with CM&NW, the best segments of numerous overlapping and parallel lines could be utilized to shorten route mileages for all three lines (T. 9906-8).

Rock Island's first choice of a merger partner, the Union Pacific, is to provide massive infusions of cash (RI 1041, p. 3). But this is no cure for any of the causes which it ascribes as the basis for its ills, without massive infusions of traffic needed to increase its freight traffic density and improve its revenue per mile of road. And there is the rub.

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[15] Real time in transit from shipper to consignee, is, of course, the true test of competitive advantage or disadvantage of a particular route not relatively small differences in rail mileages over the entire route. In this regard volume and frequency of train movements are the more significant time factors. Distance is a cost factor.

Density can be improved in two ways. One is to reduce the mileage of light density lines through abandonment. Neither Rock Island nor any one else recommends this course for Rock Island (T. 9890-93; 33666). Moreover, no such proposal is pending or contemplated in this proceeding. The only other avenue for improving density is by massive infusions of new traffic over Rock Island lines. The surest and easiest source of this new traffic is by diverting it from other railroads (Soo 543, pp. 7, 9-10; T. 9911-13).

Consequently, the Rock Island's first solution to its problems is to go out of business and turn its lines over to Union Pacific and Southern Pacific to operate for their respective benefit with Union Pacific guaranteeing Rock Island debts and its stockholders a dividend.

The better solution from a sound economic point of view is its second choice, a merger with CM&NW where unneeded competing main lines can be reduced to secondary lines and duplicating terminals and other facilities and services can be eliminated in favor of shorter more direct routes and more efficient terminals providing faster service for more traffic at lower cost. Substantially reduced costs through reductions in excess capacity also produce cash for equipment and necessary roadway maintenance.

North Western's four-way study indicates that Rock Island can gain $7,791,326 in operating and overhead savings and traffic benefits of $5,611,526 or a total improvement in its net income of $13,402,852 under control of CM&NW. Benefits of over $8 million principally through operating savings, would accrue to CM&NW as well (CNW 1215, p. 11). Obviously, an ultimate merger of Rock Island into CM&NW would permit an even greater savings to the combined companies. The conclusion is that under control Rock Island's earning power is improved substantially and it also adds to the needed earning power of the CM&NW. This combination of railroads improves the financial condition of all the lines involved and produces substantial reductions in operating costs. However, with a majority stock interest in Rock Island, the desire of CM&NW to obtain further merger benefits by consolidating or merging Rock Island with CM&NW will be very strong.

D. Conditions Proposed By Other Railroads To CM&NW Control Of Rock Island Are Not Justified.

1. Rio Grande's Request for the Lines of the Rock Island West of Missouri River Should be Denied.

The Rio Grande has taken the position that in the event of control of the Rock Island by the CM&NW it should be sold the lines of the Rock Island West of Missouri River. Aside from the fact that under control it is premature, this requested condition is unreasonable and completely unwarranted. The reason for the condition as stated in the position of Rio Grande in the joint brief is that merger of Milwaukee and North Western and CM&NW control of the Rock Island would divert traffic from the Rio Grande causing it to suffer serious financial damage.[16] Witness J. D. Key stated that "Rio Grande opposed an unconditional approval of the four-way combination, because of the serious adverse impact that such a combine would have upon Rio Grande's revenues." (DRGW 1282, pp. 1-2). The diversion of traffic asserted by the Rio Grande as a result of a CM&NW merger and control of Rock Island is grossly exaggerated.

[16] Joint brief, pp. 41-42.

The Rio Grande when estimating its potential losses has apparently adopted the theory that if there is any possible way in which traffic can be lost, the Rio Grande will lose it, even if the route to which the traffic is diverted is totally impractical. From the testimony of the Rio Grande, it is asserted that a North Western-Milwaukee combination would assert their influence to divert traffic to (1) Milwaukee's northern route, (2) to the Rock Island's Tucumcari Route and (3) from Rock Island's Denver route to a CM&NW-Union Pacific Fremont central route. It appears that the contention of the Rio Grande is that a four-way combination would consciously dry up the traffic moving via the Rock Island's Denver route.

A rational approach will prove that the Rio Grande has not given this matter logical treatment. In numerous instances the Rio Grande has the Rock Island being short hauled or losing the haul altogether (Milw. 1288, See reference to Sheets 1040, 3032, 2088, 2121-2124, 1904, 1935, 2046 on page 3, all of page 4, and all of C on page 5). Under control the CM&NW would not jeopardize 54% stock ownership by drying up traffic on the Rock Island. It would be the height of folly for the CM&NW to aid in pushing the Rock Island to bankruptcy where its investment could be wiped out. North Western has indicated that the control of Rock Island is merely a step toward merger, but even if this study of the Rio Grande is regarded as assuming such a merger it exaggerates the effect on Rio Grande to such an extent that the credibility and value of the study is doubtful for any purpose.

In making the study, Rio Grande asserts CM&NW will divert traffic wholesale from the central route to all other routes. Rio Grande asserts that $4,244,000 of their gross revenue would be lost as a result of the four-way combination (DRGW 1282, p. 2). Of this amount, $2,637,832 would be from traffic rerouted to Milwaukee's line to Portland, and $1,605,851 of Rio Grande's revenue would be rerouted to Tucumcari and via Fremont with the Union Pacific at Denver (CNW 1276). Rio Grande relies on the principle that a rail carrier's interest lies in its long haul routes. It recognizes this principle in connection with all routes apparently, except the routes via the central transcontinental corridor. The Rio Grande seems to think the CM&NW with Rock Island will seek its long haul on the northern and southern transcontinental routes but will short haul itself to Denver on the central route preferring Union Pacific at Fremont. This position overlooks the dominance of the central route.

The central transcontinental route has an inherent advantage over the other transcontinental routes. The central route reaches the entire Pacific coast equally competitive with all routes. The northern transcontinental route of Milwaukee is competitive with the central route to Washington and Portland, Oregon. The southern transcontinental route of Southern Pacific is competitive with the central route in southern California. Both of these the north and south routes are at a competitive disadvantage reaching central California and southern Oregon versus the central route. The dominance and advantage of central route is disclosed by our density chart for Western lines attached hereto as an Appendix. Certainly the CM&NW would not sacrifice the advantages of the central route nor will shippers route traffic against the central route to the northern transcontinental routes. The two Northern Lines together with their family line the Burlington have existed since 1900 with rates and routes to central California without noticeable affect on the central routes including the Rio Grande. The Rock Island has preferred the Tucumcari route but Rio Grande considers Rock Island a valuable connection at Denver nevertheless. The advantage of the central route will not disappear by CM&NW control of Rock Island.

The Union Pacific when it made diversion estimates on the four-way study did not foresee a diversion of California business to the northern route of the Milwaukee. Union Pacific did see that the four-way combination would use the Denver gateway. Union Pacific estimates a traffic loss on CGW, Milwaukee, North Western and Rock Island business by being short hauled, losing the haul between Council Bluffs and Denver on central California business (T. 47185).

The Rio Grande in diverting long haul transcontinental business from their lines to the northern line of the Milwaukee to central California has seriously overstated their case and misunderstood the facts. On this record there is no evidence of the service to be provided by the CM&NW to Portland and in connection with other carriers to California. The northern route must be considered a circuitous route to reach central California. The Rio Grande in making its diversion estimates has completely disregarded the unrebutted testimony concerning the Milwaukee's northern route with the Portland condition. Mr. George H. Kronberg testified as follows:

> "Nevertheless, we do not expect to gain any substantial volume of traffic at the expense of the Central or Southern route carriers from this Milwaukee condition. In the first place, moving our interchange point from Marengo to Portland is not going to change the Southern Pacific's views about routing traffic from its territory over our northern route,

> which I have already described. The principal additional traffic that we will get transcontinentally, via our northern route, between points east of Twin Cities and points south of Portland is that which is either moving via one of the Northern Lines now in connection with the Milwaukee east of Twin Cities or that which requires transit or a stop privilege at a Milwaukee point west of Twin Cities." (Milw. 658, p. 15).

In addition to the testimony of witness Kronberg, the Commission in the *Northern Lines* case at the request of the Western Pacific, a central route carrier, imposed a condition on the Milwaukee's northern route. The condition would undoubtedly be binding on Milwaukee's successor. In the Northern Lines case condition 19 was imposed providing for equal rates and service between Northern California and Midwest states served by the Milwaukee via the central route as are maintained by Milwaukee on its northern route. Stated another way the Milwaukee must participate in the service via the central route on similar schedules in effect on its northern line. This condition provides the central route carriers, who have the inherent advantage on the traffic to be served, with additional protection.

In view of some of these general principles and traffic principles generally accepted which will be discussed, we will take a look at the Rio Grande's traffic diversion study of cars diverted to the northern route of the CM&NW (Milw. 1288). The exhibit places in various groupings each shipment diverted to our northern route. Each shipment shown was a 100 percent diversion and each shipment diverted was expanded by 74.6784 (Stip. T. 47338).

In the originated traffic on the Milwaukee, there are shipments which today could move by Milwaukee long haul to the Pacific Northwest but did not. Yet, as an origin carrier, Milwaukee today should have had the maximum influence. Nothing in the four-way merger will increase the Milwaukee influence on this traffic.[17] All the rest of the shipments originating on either the North Western or Milwaukee moved to Central California via Rio Grande and rerouted via the Milwaukee's circuitous northern line on which it has not been shown to be competitive from a service standpoint.[18] The record does not indicate how much more revenue would accrue to CM&NW via Portland than Rock Island via Denver. Each of these shipments if moved by the Milwaukee's northern line would short haul the terminating carriers, SP and WP, and their preferred central route via Ogden or Salt Lake.[19]

On page two of Milw. 1288 a shipment is shown from Oakland, California to Rochelle, Illinois originating on the WP. The new routing was not explained on this shipment but the WP, as the origin carrier, with maximum influence would have to be short hauled via Bieber instead of Salt Lake and the Burlington-Northern inserted in the route from Bieber to Spokane, Washington thence to the Milwaukee route in order for CM&NW to get a longer haul than via Denver.[20] A highly unusal routing. This example would be true of all traffic in the exhibit originating or terminating on the WP. Here again the record does not indicate whether CM&NW would receive a greater division of revenue via Spokane than over Rock Island lines via Denver.

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[17] Milw. 1288 lines 7 and 12.
[18] Milw. 1288, page 1.
[19] Stipulation (T. 47339-40).
[20] Milw. 1288, sheet 2160.

Reviewing the exhibit of the Rio Grande which shows the divertible traffic to a northern transcontinental route, it discloses that over two-thirds of the shipments move to or from California points. As we have pointed out, the northern transcontinental route service of the Milwaukee will not be competitive for this traffic. We have pointed out numerous reasons why California traffic cannot be expected to move via this route. At the very least the Rio Grande's losses to a CM&NW merger via the northern route should be reduced by two-thirds. If the losses occur they would result from a Milwaukee-North Western merger without the Rock Island in the combined companies.

There are other examples of Milwaukee, C&NW and CGW bridge traffic where it is asserted such shipment could move via our long haul.[21] In each instance an increase in our bridge haul would short haul the origin or terminating carriers or both. In many cases SP terminates or originated the shipments and prefers the movement via the Ogden gateway as was admitted by the Rio Grande.

Another example of the lengths to which the Rio Grande went to find diversion were cars of slow routed roller lumber traffic moving in the bridge service of the CGW.[22] It is obvious these shipments were routed via numerous carriers with plentiful junctions inserted so the cars could be sold in route. The Rock Island to St. Joseph, Missouri and CGW to Conception is a slow route for roller lumber. Surely no amount of influence by the merger of railroads will do away with such routes. These routes are part of the shipper's business and will not be

[21] Milw. 1288, page 2, all shipments under G, H, I.
[22] Milw. 1288, sheets 1904, 1935, 2046.

changed to new longer hauls for the benefit of individual carriers.

We do not here indicate that the Milwaukee line to Portland will not be productive. The new route of the Milwaukee to Portland will be of benefit in meeting the increased competition of the Burlington Northern in the area where it will do the most good, the northern tier of states. The new route will not divert transcontinental business such as indicated by the Rio Grande. In fact, the line of the CM&NW to Denver should provide the Rio Grande with increased traffic available for Rio Grande solicitation on an equal basis with Union Pacific.

The Rio Grande's fears as to the loss of Rock Island traffic moving via the Denver gateway are not in agreement with Mr. Lovett's thinking on the subject. When Mr. Lovett testified concerning the contemplated Milwaukee-Rock Island merger, he indicated that the Union Pacific felt traffic would be diverted from Council Bluffs to Denver and whether the Union Pacific would participate in the route beyond Denver was questionable. The Coverdale and Colpitts Report on the benefits of a Milwaukee-Rock Island merger indicated that approximately $4 million in traffic would be diverted from the Union Pacific to the Denver route and assumed that such traffic would move via the Rio Grande, a friendly connection of a merged Milwaukee-Rock Island. The question in the Union Pacific's mind was whether or not they would participate in this traffic west of Ogden or Salt Lake and they considered such participation problematic. Mr. Lovett in discussing the Milwaukee-North Western-Great Western-Rock Island merger, again indicated the traffic would probably be routed away from the Union Pacific via the Rock Island Denver and Tucumcari gateways (UP 1, pp. 21, 23-24).

The fact is that a forced sale of Rock Island's western lines to Rio Grande by CM&NW would create a far greater incentive to solicit against Rio Grande's central route and in favor of Rock Island's Tucumcari route or CM&NW's northern route than would be the case if these western lines were retained by CM&NW-Rock Island. Rio Grande's traffic loss estimates from CM&NW control or merger with Rock Island make more sense with the imposition of this condition than they do without it.

2. Kansas City Southern's Requested Trackage Rights Should be Denied.

We will discuss Kansas City Southern's proposed extension of its operations to Chicago and Peoria under a following section of this brief dealing with Union Pacific's merger proposal. What is said there is equally applicable in connection with its request for this condition to Commission approval of a North Western or CM&NW control of Rock Island.

IV.

THE UNION PACIFIC'S PROPOSAL OF MERGER WITH ROCK ISLAND SHOULD BE DENIED BECAUSE IT DOES NOT PROMOTE EFFICIENCY AND THREATENS TO ADD TO CHRONIC UNDER UTILIZATION AND OVER CAPACITY IN THE MIDWEST.

The case made by Union Pacific in support of its proposed merger with Rock Island is to be noted more for what condemns it than for what commends it. Stripped of all its superficial trappings and taking their case as it was finally presented, it reveals the outrageous perspective from which the examiners and the Commission are expected to view their proposal.

The Union Pacific's prime merger objective, after first having won assurance that Southern Pacific would aid and abet its achievement, is to interdict the formation of a strong Midwestern rail system made up of the Milwaukee, North Western and Rock Island in order to reach Chicago and St. Louis with its own lines. By obtaining the main routes of Rock Island through Midwestern territory to connections with the two or three emerging Eastern and Southeastern railroad systems, like Sherman's march to the sea, Union Pacific could destroy the life lines that support much of the Midwest railroad system and enhance Union Pacific's already dominent position as a carrier of long haul, transcontinental rail traffic. Nothing more disruptive to an orderly solution to the Midwestern railroad problem of excess capacity and ruinous competition could be devised.

In this part of our brief it will be shown that Union Pacific admittedly does not need merger for itself, but is motivated to seek merger with Rock Island to circumvent the effect upon its earnings resulting from the Commission's decisions in the *Transcontinental Divisions* case and the amendment to Condition E in the *Central Pacific* case[23] and secondarily to offset the effect upon Union Pacific of a probable Milwaukee-North Western-Rock Island merger.

Apparently, believing that it could not retain its position of eminence as the primary transcontinental line without a divisional arrangement for through rates with its eastern connections and a preferential solicitation arrangement with its principal western connection, which the Commission found to be unreasonable, unduly pref-

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[23] *Control, Central Pacific by Southern Pacific,* F.D. 2613, 76 ICC 508, 317 ICC 469, 229 F. Supp. 249, 328 ICC 345, 277 F. Supp. 671 aff'd 390 U.S. 744.

erential and othewise unlawful, the Union Pacific overreacted and embroiled itself in an inappropriate merger with Rock Island.

The Union Pacific proceeded with a merger proposal with Rock Island with full knowledge that there would be little or no opportunity to reduce operating costs by combining the two systems and with full knowledge that it would be required to spend some $250 million or more to bring Rock Island up to standard, but it was satisfied that sufficient traffic could be diverted from other lines to more than make up for Rock Island's deficiencies. But when it came to make a case before the Commission, it decided to minimize traffic diversions. As a consequence, its case, as presented, is deficient and eloquently demonstrates that without massive traffic diversions from other railroads, its proposal is an economic waste and with such diversions it adds to the social cost of excess capacity by forcing upon other underutilized lines uneconomical and less efficient operations.

Recognizing this deficiency, Union Pacific engaged R. L. Banks to make a study of truck competition to justify merger. As we shall show, this study, above all else, demonstrates that transcontinental truck traffic provides the poorest source of new business.

Union Pacific emphasized further growth in Gross National Product, but here again as we shall show, this does not offer a source of revenue from which Union Pacific does not already benefit as transcontinental carrier and upon which Union Pacific's merger proposal is designed to capitalize by extending its hauls.

Union Pacific attempted to emphasize intangible public benefits such as single line service but as the facts turned out such benefits simply did not materialize in this particular case. In fact, as we shall illustrate, service of all railroads would deteriorate rather than improve.

Faced with the bald fact that their's was a predatory merger, without benefit of increased efficiency through reduced costs or better service to the public, Union Pacific as a last resort now takes refuge in the fact that other mergers in the West will makeup for this very large basic deficiency in their case. Union Pacific makes this absurd argument: A Burlington-Northern merger and CM&NW merger will produce substantial reductions in operating costs through reduction in excess capacity and in turn produce stronger rail systems in the Midwest and through the northern tier of states, all of which is in the public interest. However, to include Rock Island with CM&NW to create even greater reductions in unnecessary excess capacity and provide further cost reductions and an even stronger Midwest system is not in the public interest. They even carry this novel idea to its ultimate absurdity. Not only should a combined Rock Island and CM&NW jointly forego the very substantial economic and public benefits of a four-way combination of the independent Midwestern lines, but that a substantial part of the benefits or reduced costs to be achieved by a Northern Lines merger and a CM&NW merger should be donated to a merged Union Pacific-Rock Island system through traffic diversions because they should then be able to afford it. The argument, in effect, concedes that a Union Pacific-Rock Island merger is parasitic and cannot stand on its own feet in order to produce any benefit in the slightest. The simple fact is that the economic and public benefits of a Union Pacific-Rock Island merger are non-existent. We will proceed to elaborate on these points.

A. The Main Purpose Of Union Pacific's Merger Proposal Is To Stifle A Merger Of Milwaukee-North Western-Rock Island And Circumvent The Effect Of Commission Decisions In Other Cases.

Union Pacific witnesses describe this proposed merger with Rock Island as both "defensive" and "aggressive" (T. 161; 1523-24; 1597; CNW CX-1). It is admitted that Union Pacific can survive without merger (T. 416). It is also admitted that a merger of Milwaukee and North Western would not be a crippling blow to Union Pacific (T. 45760-61). In fact, even a merger of Milwaukee, North Western and Rock Island could readily be withstood by Union Pacific (T. 45741-43). Union Pacific's own estimates of the combined effect of Milwaukee-North Western-Rock Island merger with the benefits of the Northern Lines Conditions of $12.1 million annually is less than 2.5 percent of Union Pacific's 1964 gross freight revenue of $483,055,883 (UP 9-A, p. 3). As Mr. Lovett testified, a reduction in gross freight revenue of "a couple percent" would not affect a railroad materially (T. 405-6).

However, if Union Pacific could get lines to the principal terminals of Minneapolis, Chicago and St. Louis and junctions with connecting lines there, it could avoid paying increased divisions to its Midwestern connections at the Missouri River on the preponderance of its transcontinental traffic. If it obtained the lines of Rock Island it would accomplish this objective and also could offset in part at least, the effect of Rio Grande's efforts to amend Condition E of the *Central Pacific* case by diverting Rock Island traffic to Union Pacific west of Denver (T. 327; 463).

On the 6th day of December, 1960, the examiners' report in the *Transcontinental Divisions* case was issued proposing increased divisions for Midwestern and Eastern railroads participating in joint through rates on traffic moving between Mountain Pacific territory and the Midwest and East. Inasmuch as some 50 percent of Union Pacific's total freight revenues were transcontinental in nature, this report was a matter of concern to it (UP 1, pp. 15-17). At about the same time, the examiners report on Rio Grande's petition to amend Condition E in the *Central Pacific* case was issued recommending the change sought by Rio Grande (UP 1, pp. 13-15).

Immediately after these two reports were issued, Union Pacific, in the spring of 1961, began a study of its 1960 transcontinental traffic interchanged with its Missouri River connections and completed it in the Fall of the same year (UP 9, pp. 9-15). From this study, using information developed in the *Transcontinental Divisions* case, Union Pacific concluded that a merger with Rock Island would provide the largest pool of traffic available for diversion to a combined Union Pacific-Rock Island system and expose the smallest volume of Union Pacific traffic to diversion from this combination. Union Pacific's 1960 traffic study showed that while \$107.4 million of Union Pacific's revenue could be exposed to division by other lines, a Union Pacific-Rock Island merger would expose \$229 million of other lines revenue to gain by a Union Pacific-Rock Island (UP 9, p. 14; CNW CX-1).

This study was submitted to Mr. William Wyer, transportation consultant, for review. He analyzed the data and reported his views to Union Pacific in a letter of February 26, 1962 (UP 1, p. 47; UP 9, pp. 13-15). Wyer reviewed the maximum effect upon Union Pacific revenues by various proposed combinations, particularly a Milwaukee-North Western merger, a Milwaukee-Rock

Island merger and a Milwaukee-North Western-Rock Island merger and concluded that the latter merger could have the greatest effect upon Union Pacific revenues than either of the other two combinations. He concluded that a merger with Rock Island would more than offset the revenue losses of any proposal reviewed and recommended an "aggressive" policy (CNW CX-1).

Union Pacific and its consultant, Wyer, knew from the 1955 study Wyer made of a Milwaukee-North Western merger that total traffic gains from all other railroads by that merger were some $13 million of which Wyer, by his horseback estimate made in this case, assigned some $3 million as loss by Union Pacific (UP 4 EE, WW-19; T. 2369-71). Union Pacific also knew from the Coverdale and Colpitts 1960 report on merger of Milwaukee and Rock Island, which apparently was available to them, that estimated revenue losses to Union Pacific from that proposed merger was $4,021,502 (UP 1, p. 24). Neither of these mergers seriously threatened Union Pacific. While Wyer's letter concludes that a combination of Milwaukee, North Western, and Rock Island might threaten some $55.9 million of Union Pacific's revenues, even Union Pacific recognized that such a loss was not to be expected (UP 9, p. 15). The Union Pacific's final estimate of loss from such a merger is only $12,124,033 (Joint brief, p. 253).

The effect of this loss is not serious to Union Pacific after deducting cost of handling and income taxes which the following table shows:

UNION PACIFIC 1964

Net income (UP 3, Ex. —, p. 3) .		$ 85,463,643
Fed. income taxes (UP 3, Ex. —, p. 3)		23,300,000
Net before fed. income taxes		108,763,643
Revenue loss	$12,124,033	
Less cost of handling @ 40.3% (Joint brief, p. 251)[24]	4,885,985	7,238,048
		101,525,595
Adj. taxes @ 21% (23.3 ÷ 108.7)		21,320,374
Adj. net inc. after taxes		80,205,221
Loss of net income		5,258,422

This net annual loss to Union Pacific is no more than the minimum $5.25 million Union Pacific is willing to pay Rock Island stockholders annually for their equity after merger. Consequently, it was not the Midwest mergers that were its prime target in seeking Rock Island.

Moreover, Union Pacific, for itself, saw no real benefit in mergers. Despite the fact that *Union Pacific in 1961 and early 1962 was evaluating which of its Midwestern connections would serve its interests best for extending its operations to Chicago and St. Louis, it was not convinced that merger benefits provided the answer to railroad problems.* Its 1960 annual report to stockholders, issued in the Spring of 1961, when it started its 1960 traffic study, had this to say about mergers:

> "In 1960, the financial difficulties of certain railroads were intensified. At the same time, the impression grew that the merger panacea could cure almost any railroad in trouble, and be beneficial even to those in relatively good condition. This is not necessarily true. Such thinking could lead to pre-

[24] Union Pacific did not make a relievable cost study.

> cipitous merging of railroad companies as distinct from logical regrouping of underlying transportation properties.
>
> "While elimination of unneeded facilities and services and the joint use of properties are desirable, the basic reason for the dismal outlook of some segments of the industry is that the interest [sic industry] does not have freedom from discriminatory regulation; freedom from discriminatory taxation; freedom from subsidized competition; and freedom from restrictions against engaging in a diversified transportation service." (T. 281-282)

These views were reiterated in early 1962 when its 1961 annual report to stockholders was issued.[25] These statements were made at a time when Union Pacific was fully cognizant of the fact that the Northern Lines merger was in the hearing stage. Merger talks between North Western, Milwaukee and Rock Island had been going on from time to time but no definitive proposal had been agreed upon (UP 1, pp. 20-26; CNW CX-1).

However, in June of 1962, Union Pacific learned that Southern Pacific was already discussing merger with Rock Island. This galvanized Union Pacific into action, resulting in the August 23, 1962 San Francisco agreement to divide up Rock Island between Union Pacific and Southern Pacific to protect their respective "spheres of influence" (UP 1, pp. 47-51; UP 9, p. 15; CNW CX-2). Plans were laid and preliminary talks were had with

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[25] "Additional proposals for railroad mergers were put forward in 1961, and hearings on some were held by the Interstate Commerce Commission. In some cases, such mergers should prove beneficial to the railroads concerned. However, many of the proposed mergers can at best serve only as palliatives for basic railroad ills. The railroads will not be restored to health until archaic governmental attitudes toward the industry are changed and legislation is enacted in conformity with present-day realities and equitable principles." (T. 283)

Rock Island but when the Commission's decision in the *Transcontinental Divisions* case was issued in March of 1963, Union Pacific moved quickly. By the end of April, 1963, an agreement was reached with Rock Island for an exchange offer of 0.718 shares of Union Pacific common stock for one share of Rock Island which was put into a memorandum of May 3, 1963, and announced to the public. The first plan and agreement of merger was approved by the Board of Directors of Rock Island and Union Pacific June 27, 1963 (UP 1, pp. 51-52).

This first plan was to be submitted to Rock Island stockholders at a special meeting called November 15, 1963. However, Union Pacific's offer was countered by North Western's exchange offer and a proxy fight ensued (UP 1, p. 52). Seemingly, there was some doubt about the outcome of this stockholders' meeting because Union Pacific commenced a suit against North Western and won postponement of this meeting, *Union Pacific R. Co.* v. *C&NW R. CO.*, 226 F. Supp. 400 (UP 1, p. 53).

Thereafter, Union Pacific made a new exchange offer of one share of $1.80 convertible preferred Union Pacific stock for one share of Rock Island common plus a cash payment on consummation of merger of 45 cents per quarter for three years from July 1, 1964 to June 30, 1967 to those accepting the offer. Of Rock Island's 2,916,911 shares outstanding, 2,280,789 accepted this offer at a stockholders meeting of January 7, 1965. As a result, should Union Pacific's proposal be consummated, the merged system would have to provide earnings to pay Rock Island stockholders preferred dividends of $1.80 per share on 2,916,911 shares. This would be $5.25 million charge against net income after taxes in perpetuity. If preferred stock of former Rock Island stockholders is converted, then Union Pacific and Rock Island stockholders share the net earnings of the combined companies on the basis of one Rock Island share for .85 of one share of Union Pacific common. In addition, there must be paid out of Union Pacific earnings, the cash payment of $1.80 per share to accepting stockholders for the three year period July 1, 1964 to June 30, 1967. This amounts to $12,316,260 in cash payable on $2,280,789 shares (UP 1, pp. 53-62; 67-71).

As Union Pacific admits, this sweetened offer was prompted by its apprehension about changing traffic patterns which might be brought on by other proposed mergers, but more specifically to protect it from a probable revision of the *Central Pacific* case conditions and reduced transcontinental divisions (UP 1, p. 54).

The Union Pacific knew before they entered into negotiations with Rock Island to implement their program, that they would have to spend some $146.8 million for roadway and $118.1 million for equipment or some $264.9 million to bring Rock Island up to minimal Union Pacific standards (UP 1, p. 45). They also knew that because their proposed merger was primarily end to end, there were no important savings through merger to reduce operating costs of the combined companies to produce this money (T. 108; 350). They only knew from their 1960 traffic study to their own satisfaction that it would afford them the opportunity to divert substantial traffic from connections and competitors of the proposed system and proceeded to a merger agreement on that knowledge alone (T. 364).

By merging with Rock Island, Union Pacific figured it could bypass and divert from its Missouri River connections the greatest volume of transcontinental traffic and thereby circumvent the Commission's decision in the

Transcontinental Divisions case and at the same time reduce the benefits to Rio Grande from revisions of Condition E. Improved service to the public or greater economy and efficiency in transportation among the several rail carriers was not even considered until after they had a merger agreement with Rock Island.

By 1965 they had such a merger agreement with Rock Island and a commitment with Southern Pacific to proceed with a merger and sale of the southern segment of Rock Island to Southern Pacific. Now they had to make some kind of a case to the examiners and the Commission. They hired Wyer, Dick & Co. to study possible savings in joint operating costs. They proceeded with joint traffic diversion studies, although they decided to "disavow" increased income through traffic diversions as "fatal" to their case before the Commission. (CNW CX-6; T. 99-117).

B. The Case Presented By Union Pacific Demonstrates That Without Massive Diversions Of Traffic From Other Railroads, Its Proposal Results In Economic Waste.

1. The Wyer Report Confirms that Cost Savings Through Merger are Minimal.

Wyer, Dick and Company made three reports on the economics of merger of Rock Island with Union Pacific and sale to Southern Pacific. These will be referred to as the Wyer Reports and as originally submitted in this case are Exhibits 4-A, 4-B and 4-K. These reports respectively cover a Union Pacific-Rock Island merger without sale, referred to as "full merger," a Union Pacific-Rock Island merger with sale of south half of Rock Island to Southern Pacific (UP-RI (N)), and Southern Pacific purchase of the said south half (SP-RI (S)).

There were eleven separate studies to Exhibits 4-A and 4-B, including Study 8, which was a traffic study made by Union Pacific and Rock Island traffic officers, referred to as the "MacAnally Study" and the "Hatcher Study" covering 1963 interchange traffic (UP 9, pp. 15-20; UP 9A, p. 62 Rev.; RI 23). Wyer assumed no responsibility for the Union Pacific's revenue gain or loss figures in Study 8, except for general instructions and the costs of handling computations shown in Study 8 (T. 3488-91). These studies were submitted originally to reflect 1966 cost levels. Later, on rebuttal, these studies were updated to 1968 levels and adjustments made to reflect matters brought out in cross-examination and in opposition testimony submitted during the course of the hearing (UP 1043, pp. 85-104). Accordingly, we will assume that the Wyer reports, as updated, are what should be dealt with. While the reports themselves purport to show the effect of merger upon net income, they in fact only show the effect on net income before fixed charges and Federal income taxes and other tax changes (UP 4 EE, WW-19).

Wyer also made a study of roadway improvements required to handle the increased volume of traffic shown in the studies, and the equipment needed to improve Rock Island's car fleet to competitive standards (UP 4D). The roadway improvement program only covered main line improvements to the Rock Island lines between Omaha and Chicago and between Kansas City and St. Louis (UP 4D). These studies were also updated on rebuttal (UP 1043, pp. 83-90). However, the Wyer Reports do not reflect the added annual cost these equipment and roadway improvement programs would have on his merger savings or upon net income.

Studies 5 and 8 of the two Wyer reports for Union

Pacific came under particularly heavy fire on cross examination and in testimony of opposing railroads. As a result of cross examination and Milwaukee opposing testimony, the net savings in Study 5 were reduced from \$2,858,946 in the original report to a mere \$16,000 on rebuttal (UP 4A, 4B; Milw. 626; UP 1043, pp. 91-94). We believe that the expected increased passenger revenue from transferring the City Trains from the Milwaukee to the Rock Island lines, even after the adjustments on rebuttal, are grossly overstated, and in light of the fast changing picture with respect to passenger service, the entire Study 5 should be disregarded and we shall so consider it (Milw. 626).

Study 2 of each report involves the elimination of certain duplicate lines through abandonment. This study should also be disregarded as a source of merger savings. Union Pacific has disavowed any intention of abandoning these lines (T. 906; 921). Moreover, there is no application pending for abandonment of the segments of line covered by Study 2. Accordingly, they cannot be considered in this proceeding. See *Great Northern Pacific & Burlington Lines, Inc. supra* at page 236 Study II. We shall consider Study 2 as eliminated from net savings shown in the Wyer reports in this case also.

Throughout his operating studies, Wyer capitalized final net cash required at 5 percent per annum, assuming that this would be the minimum earned on this cash from any source, and therefore annual savings should reflect only those savings above this annual return. (T. 44971; 44980-81). The effect is to reduce savings by a return of 5 percent per annum on funds required to produce the savings.

In preparing his reports (UP 4A, 4B and 4K), Wyer used 36 percent as the effective Federal income tax rate for non-recurring tax reducing events in order to increase net savings. On rebuttal Wyer reduced this to 24 percent to reflect more recent income tax experience due to greater use of investment tax credit (UP 1043, p. 96). He also used a 36 percent tax factor to reduce the cost of labor protection (Study 10 of Exhibit 4A and 4B and Study 8 of 4K) to arrive at a net final cash which he then annualized at five percent and charged the annualized cost of labor protection as thus reduced against other estimated final savings. On rebuttal, the tax factor for this study was also reduced to 24 percent (UP 1043, p. 99).

Furthermore, in appraising the effect upon a Union Pacific-Rock Island net income caused by loss of part of Rock Island's net income upon sale of the south half of Rock Island lines to Southern Pacific, Wyer used an effective tax rate of 36 percent to reduce this to an after tax loss (UP 4B, p. 6). This computation, however, is not reflected in the final net savings shown in the Wyer reports as originally presented or as updated. Consequently, to arrive at the effect of the final net savings upon net income after taxes the final savings should be reduced by the same tax factor as used in the studies to offset cash expenditures (Exhibit 4A, p. 3). This generous reduction in the tax percentage on rebuttal had the effect of reducing net operating savings slightly, but as we shall see had far greater advantages in the end result when we get to the pro forma net income.

After eliminating Studies 2 and 5 from the Wyer Exhibits 4A and 4B, as updated by Exhibit 1043, and eliminating Study 8 dealing with traffic diversions, which are not truly savings and which will be separately considered below, the final net savings from merger of Rock

Island with Union Pacific, with and without sale of the south half to Southern Pacific, after income taxes are as follows:

	UP-RI (Full)	UP-RI (N)
Total annual savings	$11,101,000	$5,393,000
Less 24% Fed. income tax	2,664,240	1,294,320
Improved annual net income after Fed. income tax	$ 8,436,760	$4,098,680

This does not reflect probable increased state property taxes which follow changes in earnings (Milw. 630).

2. Union Pacific's Pro Forma Income Statements When Properly Evaluated Indicate That a Huge Increase in Revenues is Required to Make Their Proposal Financially Sound.

On rebuttal Union Pacific presented a pro forma income statement for the year 1967 to show that with Wyer's savings, including Studies 2 and 5, as revised by Wyer and Study 8 as revised on rebuttal by Witness MacAnally, the net income after full merger with Rock Island would be $103,047,000 as compared with Union Pacific's separate net income of $102,133,000, after income taxes. Assuming conversion of Rock Island stockholders', Union Pacific preferred stock to common, earnings per share were estimated at $4.13 (UP 1083, RMS-L). This is to be compared with $4.42 per common share for Union Pacific shareholders separately as reported in its 1967 Report to Stockholders. Multiplied by the number of shares of stock of the merged company this difference exceeds $3 million.

As a late filed exhibit, Union Pacific put in the record Exhibit 1356 containing pro forma general balance sheet as of December 31, 1967, and income statements for the years 1966 and 1967 assuming, (1) full merger, (2) sale of southern Rock Island lines to Southern Pacific, (3) sale of Rock Island Western lines to Rio Grande and (4) assuming sale of Rock Island southern segment to Southern Pacific and Rock Island western lines to Rio Grande. In each of the assumptions for the year 1967 other than full merger, the combined income after all savings and traffic diversions covered by Wyer's reports as adjusted, net income and earnings per share sank even lower.

But, of course, this does not begin to tell the story. As mentioned, Wyer also estimated the added equipment that would be required to bring Rock Island's car fleet up to a competitive standard (UP 4D, WW 27). On rebuttal, net funds required for this proposed equipment program was scaled down from $153,844,100 in case of full merger and $107,771,600 for the northern segment of Rock Island to $124,431,300 and $81,268,700, respectively, because of Rock Island's own improvements to its equipment requirements. (UP 1043, p. 85, App. K). This was done despite the fact Union Pacific had earlier asserted the original estimate would be carried out despite what Rock Island might do for itself (T. 1509-10).

Using the same method and factors as Wyer used in his reports with respect to above savings, the annual cost at 5 percent per annum of the cash requirements for this equipment program, as updated, is $6,221,565 in case of full merger and $4,063,435 for the northern segment only.[26] Union Pacific assures that upon approval of its

[26] We recognize that Union Pacific would only be required to provide cash for a 20% down payment on the equipment program and would finance the balance through equipment obligations. A 5% return on 20% down payment of $124,431,300 is $1,244,313 and on $81,268,700 is $812,687. While it may be that depreciation and other non funds sources may release cash

proposal, it will underwrite and carry out this program (T. 380; 921; UP 1085 pp. 20-22).

Wyer originally estimated that Rock Island lines between Council Bluffs and Davenport and Kansas City and St. Louis requires certain line changes, signals and sidings and a microwave communication system to handle the increased volume of business over these lines as covered by Study 8 of his reports (UP 4A, 4B). The cost of these capital expenditures for roadways at 1964 levels was estimated at $28.4 million (UP 4D, WW 24). On rebuttal, this estimate was revised and adjusted to $30 million. Again, the annual cost of this cash expenditure at five percent is $1.5 million. This, of course, only covers the expense of increasing the capacity of the two main east-west lines of the Rock Island.

These expenditure for roadway to increase capacity of Rock Island lines, and the expenditure for a new yard at East St. Louis contained in Study 3 of the Wyer reports (UP 4A; 4B) are clear evidence that Union Pacific's merger plan intends to add to excess capacity in the Midwest, rather than reduce it.

Mr. Langdon, however, estimated that the Rock Island needed $119,811,000 cash expenditures for roadway to bring all Rock Island lines up to adequate standards (RI 586, JL-2; RI 1041, pp. 4-5). According to the Coverdale and Colpitts study this should be divided between Rock Island-North and Rock Island-South at approximately 62 percent north and 38 percent south (UP 8,

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to carry fixed charges on the balance of the program, this source of cash must be produced from earnings if the program is to be maintained. For the purpose of the showing to follow we have assumed a need for earnings to continue the program and therefore assumed the entire program as a cash requirement. (T. 45762-74) pp. 19-20, Sch. 1). Capitalized at 5 percent, this would represent an annual cost of $5,990,550 in case of full merger and $3,714,141 for Rock Island-North after sale of the South half.

To summarize, the above capital cost of the Union Pacific's equipment program and the Rock Island's estimate of roadway requirements, using Wyer methods is as follows:

	UP-RI (Full)	UP-RI (N)
Total annual savings	$ 11,101,000	$ 5,393,000
Less annual cost of equipment program	6,221,565	4,063,435
	$ 4,879,435	1,329,565
Less annual cost of roadway program	5,990,550	3,714,141
Annual savings deficiency	$(1,111,115)	$(2,384,576)

Accepting Union Pacific's Pro Forma Income Statements, but eliminating Studies 2, 5 and 8 from merger savings as previously explained and adding as a merger expense the annual cost of equipment and roadway improvement programs set forth above, it works out as shown on the following pro forma tables for the years 1966 and 1967 (UP 1083, RMS-L; UP 1356).

Table I

1966 (000's omitted)

	UP-RI (Full)	UP-RI (N)	
UP net income	$ 109,792	$ 109,792	
Fed. income tax accrued	24,100	24,100	
UP pretax net income	133,892	133,892	
RI net income (loss)	(3,639)	(8,770)	(a)
Combined pretax net income	130,253	125,122	
Merger savings	11,101	5,393	
Annual cost of equipment and roadway programs	(12,212)	(7,778)	
Interest on debentures	(3,563)	(3,563)	
Increased interest on new bonds		(1,335)	(b)
Return on $120,000,000 cash		6,000	
Adj. pretax net income	125,579	123,839	
Est. Fed. income tax @ 24% (c)	30,139	29,721	
Adj. net income after income taxes	95,440	94,118	
R.I. stockholders dividends	5,250	5,250	
Bal. for UP stockholders and other corporate purposes	$ 90,190	$ 88,868	

(a) ($3,639) plus ($5,131) Adjustment (1) UP 1356-H.

(b) ($3,090) less $1,755 Adjustments (4) and (5) (UP 1356-H),

(c) Wyer's 24% is used to be consistent with his study of savings and because the basis for adjusted Federal income tax is not explained in connection with late filed UP 1356.

Table II

1967 (000's omitted)

	UP-RI (Full)	UP-RI (N)	
UP net income	$ 102,133	$ 102,133	
Fed. income tax accrued	13,100	13,100	
UP pretax net income	115,233	115,233	
RI net income (loss)	(16,677)	(15,539)	(a)
Combined pretax net income	98,556	99,694	
Merger savings	11,101	5,393	
Annual cost of equipment and roadway programs	(12,212)	(7,778)	
Interest on debentures	(3,563)	(3,563)	
Increased interest on new bonds		(1,335)	(b)
Return on $120,000,000 cash		6,000	
Adj. pretax net income	93,882	98,411	
Est. Fed income tax @ 24%	22,532	23,619	
Adj. net income after income taxes	71,350	74,792	
R.I. stockholder dividends	5,250	5,250	
Bal. for UP stockholders and other corporate purposes	$ 66,100	$ 69,542	

(a) ($16,677) less $1,138 (UP 1356-D).
(b) ($3,090) less $1,755 (UP 1356-D).

The difference between (1) the UP pre tax net income reduced by 24% tax rate to $87,577 for 1967 and $101,758 for 1966 and (2) the balance for UP stockholders and other corporate purposes shown in the above tables measures the magnitude of the Union Pacific's contribution to its proposed merger program from after tax net income. This difference ranges between $11.6 and $21.5 million for the two years without sale of the south half and between $13 and $18 million with this sale. The range of contribution by Union Pacific depends upon the contribution Rock Island lines can make to after tax net income for the combined companies. This difference is what must be earned from increased revenues to only break even.

If we accept this conclusion, then based upon 1966 and 1967 earnings of the combined companies assuming sale of the south half to Southern Pacific, Union Pacific studies of traffic gains of $10.3 million, after deducting cost of handling, falls far short of the $13 to $18 million required to merely cover the merger program. This deficiency does not reflect the annual value of the $12.3 million retroactive cash dividends to be paid Rock Island stockholders. Of course, no one and especially the Union Pacific or its stockholders expect to annually contribute this kind of equity money to the merged system for the privilege of guaranteeing Rock Island stockholders a dividend or, upon conversion, participating in reduced earnings per share. According to Union Pacific's own evidence the merged company will earn less than the two companies now do in the aggregate as separate companies.

When confronted with the problem exposed above, Union Pacific's executive witness explained that this difference would be made up from increased revenues to be obtained from an increasing transportation market through increasing gross national product and from recapturing a larger share of traffic from other modes of transportation (T. 45762-74).

This hope is unsupported by the record as we shall demonstrate.

3. A Growing Economy and the Hope of Recapturing Traffic from other Modes will not Cure the Earnings Deficiency.

Union Pacific's executive witness explained that increased revenues would be obtained from an increasing transportation market through increasing gross national product and from recapturing a larger share of traffic from other modes of transportation (T. 726; 903; 1270; 45767). This is pure speculation.

The gross national product has been growing at a more or less expanding rate since before World War II. This growth is reflected in the total transportation of intercity traffic (UP 18G, Table IV-2; CNW 648, p. 82). The railroads' proportion of this has, of course, fallen, although in absolute terms, the railroads as a whole have also participated in a growing volume. However, this absolute growth, at least for western railroads results primarily from the increasing volume of traffic handled by Southern Pacific, Union Pacific and Santa Fe (T. 590; Milw. 658, GHK-1; CNW 648, p. 104, Chart 13.2). The long hauls between Mountain Pacific territory and particularly California on the one hand, and the industrial Midwest and East, on the other, have held the preponderance of the expanding trade between these population centers to the railroads (CNW 119, pp. 1 and 9, Table III-4). But an expanding national economy has done nothing to increase the volume of traffic handled by the Midwestern railroads. Their relatively short hauls within the Midwest are particularly vulnerable to movement by other forms of transportation (CNW 648, pp. 122-124, 155-159; CNW 649, Tables 13.13, 13.14, 14.16 and 14.17; CNW 119, p 1). The Midwestern railroads loss of traffic to other modes within the Midwest has offset their participation in an increasing volume of transcontinental and interterritorial rail traffic so that their volume remains static (Milw. 658, GHK-1).

While the expectation of an increased volume of business due to increases in gross national product should and does help the Transcontinental Lines most, because railroads have been better able to hold on to a larger share of this business which makes up a larger proportion of the Transcontinental Lines' business. A merger of Union Pacific with Rock Island would not add to this expectation, unless this additional traffic is obtained at the expense of other railroads.

Furthermore, the hope that a larger share of intercity traffic can be recaptured from other modes, is simply not going to come about by reason of a Rock Island-Union Pacific merger, since this merger offers nothing of real substance in improved schedules or service that would not otherwise take place, and it offers nothing of substance which would reduce operating costs significantly. In the areas of their greatest efficiency, long haul heavy movements, railroads have held the bulk of the traffic, especially transcontinentally. Inasmuch as they now handle over 75 percent of this traffic, it offers the least opportunity for recapturing added volumes of traffic (T. 152-154).

The Union Pacific and Southern Pacific introduced in these proceedings through one witness, R. L. Banks, a mass of statistics on intermodal transportation competition (UP 18, A-H; SP 18G). What all this evidence was supposed to prove at the time it was introduced is less than clear. The conclusion Mr. Banks reached was that motor carrier competition is "widespread" and "pervasive" (T. 8107-08; 8306-12). The evidence might be thought to show that railroads do not have a transportation monoply because motor carrier competition is substituable for rail competition (T. 8148; 8321). After cross examination it could not be contended that either of the above views are valid (T. 8150; 8174; 8304-05; 8311; 8332).

After making the exhaustive study contained in the exhibits Mr. Banks agreed and his testimony confirms that the railroads' share of the traffic increases as the length of haul increases (T. 8078). He agreed that as a generality the longer the haul the greater the inherent rail advantage (T. 8077). The record is replete with examples of this basic fact of transportation life (T. 8091; 8106; 8126; 8134; 8150; 8174; 8303; 8311; 8339). At one point Mr. Banks recognized that railroads, contrary to the conclusions he originally inferred, do have effective monopoly on some long haul traffic (T. 8150; 8174-78).

In the field of transcontinental transportation of lumber, Mr. Banks thought that 1.4 per cent moving by water eastbound was evidence of competition for railroads (T. 8106). Later by his own figures, he showed that transcontinental railroads were effectively meeting this water competition (T. 8385-88).

All of his testimony and exhibits firmly established that the major competition of motor carriers was for the shorter haul traffic. That motor carrier competition was most effective within regions or territories and that motor carrier participation in transcontinental traffic was not overwhelming or of substantial proportions (T. 8085-86).

Union Pacific and Southern Pacific are predominate in the transportation of long haul transcontinental business. As already mentioned the average length of haul of the Union Pacific is 615.22 miles and of the Southern Pacific is 500.26 miles. Over 50 per cent of the Union Pacific business is long haul transcontinental traffic and approximately 45 per cent of Southern Pacific's revenues accrue from this same source (UP 9A, p. 10).

When it was pointed out to Mr. Banks that the railroads' average length of hauls were on the increase and the motor carriers' average length of hauls were decreasing or remaining static depending on the time period covered, he stated:

> "It is a significant statistic and it suggests, among other things, that the railroads have made a concerted and partially successful effort to serve their heavy loading, long-haul traffic with an increasing amount of modernized facilities and service improvements." (T. 8339)

It certainly appears that the railroads have been making the most of their advantages in the transportation of long haul traffic. Transcontinental truck traffic affords the least prospect as a source of increased revenues. The Union Pacific motivation in this case is to extend its haul east of Missouri River to Chicago and St. Louis (T. 449; 619-20; 1195; 1351). It was stated the primary reason that this application was in the public interest was because of the single line transcontinental service to be provided (T. 200; 1195). However, railroad participation in long haul transcontinental traffic does not depend on single line service. Railroads generally participate in the greatest share of this long haul traffic in joint line service (T. 22754-57; CNW 119, p. 10, Tables III-4, III-5).

Attacking the problem of effectively competing for traffic with other modes on any significant scale is an industry wide day to day activity. The problem is related to functional distribution and industry logistics involving the inherent advantage of the several modes. It is generally a matter of total cost. Regional mergers which can reduce rail operating costs substantially would aid this, but a Rock Island-Union Pacific merger would do nothing to reduce rail costs of operation to a more competitive level. Where distribution can be made out of the point of production by truck with savings in warehousing and inventory, rail hauls will be eliminated unless revised rail costs can absorb the difference.

Although the expectation of increased traffic from a growing national economy will be realized by Union Pacific without merger, it cannot be realized by the Midwestern railroads unless they can also continue to participate in the growing volume of transcontinental traffic which is now fragmented and thinly spread over several undernourished competing Midwestern lines.

The hope of recapturing a larger volume of intermodal competitive traffic is dependent most upon recapturing it from the shorter hauls and this is a cost matter as well as service. Reducing terminals and, hence, terminal costs as well as line-haul costs offers the greatest opportunity along this line, not increasing investment in terminals and lines as proposed by Union Pacific.

Consequently, Union Pacific's hope of overcoming the deficiency in net income brought about by its proposed merger program and to enhance the Union Pacific's earnings and competitive position, is dependent primarily, if not entirely, upon what traffic can be captured from other railroads.

4. Only Wholesale Diversions of Traffic will Supply the Increased Revenue Required to Support Union Pacific's Merger Proposal.

As has been already pointed out, Union Pacific's merger program, according to its own evidence, provides either no return or a loss to Union Pacific stockholders under the various conditions it is willing to accept. Union Pacific justifies this financial drain upon its net income on the ground that the merger is necessary to protect Union Pacific's existing traffic base and the earning power of Union Pacific's investment.

Union Pacific, of course, knows that revisions of its transcontinental divisions were deliberately prescribed by the Commission to reallocate revenues between carriers and can be further revised up or down should circumstances warrant. Union Pacific, of course, knows that revision by the Commission of the Southern Pacific preferential solicitation arrangement was intended to reallocate traffic between the Central route carriers. On rebuttal the Union Pacific added the *Per Diem* case, decided in early 1968, as another reason for needing merger (UP 1085, p. 8). Here again the Commission intended the result of which Union Pacific complains. We doubt that the Commission wishes the Union Pacific to circumvent its deliberate intent expressed in its decisions in these cases by authorizing the Union Pacific's merger proposal.

Apart from the above decisions, Union Pacific admits that neither a CM&NW merger nor a CM&NW-Rock Island combination would seriously impair Union Pacific's net earnings. Nevertheless, Union Pacific claims that its proposal is financially and economically justified with only the minimal traffic gains it has estimated.

Furthermore, so far as CM&NW is concerned it is willing to guarantee this estimate.

If we are to accept the contention that Union Pacific is willing to take in Rock Island stockholders and guarantee them a dividend or a share of Union Pacific's earning in perpetuity, guarantee Rock Island's fixed charges and supply the massive infusions of cash, Union Pacific says it is willing to do, despite the fact that this investment will not produce a return and probably a loss, the Union Pacific's proposal must be declared an economic and financial waste. This would be a reckless disregard for the earnings of Union Pacific's shareholders, including those of the former Rock Island. In this connection, perhaps a review of the comments of the Commission with respect to the Milwaukee's Puget Sound extension in 1909, resulting in its receivership in 1925 would put such a program in proper perspective. *Chicago, Milwaukee & St. Paul Investigation,* 131 ICC 615, at pp. 668-672.

Union Pacific's management agrees that it has the responsibility to its stockholders to conduct its corporate activities in a businesslike way (T. 45766). Providing transportation to the public is expected to follow the disciplines of any private enterprise considering the public interest in continuing adequate service. Businessmen know that the massive infusions of cash needed to upgrade operations and services over Rock Island lines is Union Pacific equity money, surplus withheld from stockholders for corporate purposes. This is the dearest money in the business world. It is produced from the risks of the entire corporate enterprise. Unless the entire enterprise can produce a return on this investment, after taxes, equal to what the funds could earn in the bank (cost of capital) it injures the company owners. Passing up other investments that have a higher return than the cost of capital foregoes profits. To the extent that the proposal does not earn a return sufficient to cover the added fixed charges and dividends to Rock Island stockholders, this must also be subsidized out of the Union Pacific stockholders' equity money.

Whether dealing with mergers or buying a piece of equipment, the after tax net return should not be less than what the money would produce if invested elsewhere. Union Pacific is not forced into merger because of its precarious marginal financial position or to preserve its investment in transportation properties to provide a continuing efficient service to the public. The investment Union Pacific proposes to make in Rock Island is not the same as replacing worn out locomotives or cars or renewing worn out track or replacing a washed out bridge which, if not done, wastes the rest of the investment of the railroad dependent thereon. It is an optional investment Union Pacific proposes to enhance the earning power of the transportation enterprise. The return expected on optional investments depends upon the availability of cash and the various opportunities for investment. To expect no return, or a loss, should be fatal to any optional investment if sound business judgment is used. There are many professional articles on the economics of optional cash investments and discounted cash flow methods which are applicable to optional investments such as are involved here.[27] We do not belabor the point and we do not presume to say what kind of return Union Pacific should be expected to receive from a merger from Rock Island, but it surely ought to

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[27] See, for example, "Modern Railroads," Oct., 1968, p. 72; "University of Illinois Law Forum", Volume 1962, Spring, No. 1, pp. 33, *et seq.*

be something substantial. Without it, the investment in Rock Island is a misallocation of resources.

We, of course, do not concede that Union Pacific management intends to forego a substantial return on its investment in Rock Island. We agree with every other opposing railroad, that in the interest of its owners, the merged Rock Island-Union Pacific will seek and obtain every car of freight it can get from its competitors and that it will be far more successful in influencing traffic to its lines than it is willing to publicly admit.

C. Union Pacific And Rock Island Grossly Under-Stated The Traffic They Expect To Gain From Other Railroads.

The Union Pacific and Rock Island studies of traffic diversions are not of record. After the case started the underlying work papers of those parts of their studies which pertained to individual opposing railroads were made available for inspection and copying. Each individual railroad was on its own in evaluating the studies. No opposing line ever saw the entire study to determine how its interchange traffic was treated in the study in comparison with other connecting lines. There was extensive cross examination of the witnesses sponsoring these studies by counsel for individual opposing railroads, but no purpose would be served to point out the inconsistencies brought out by this cross examination. We assume that the same criterion and factors for claiming a diversion or no diversion were applied indiscriminately to all connecting lines and with equal inconsistency.

1. Union Pacific's Study of its Interchange Traffic Should have Produced Revenue Gains of more than Sixty Million Dollars.

Union Pacific studied commercial and company material line haul traffic interchanged with its eastern connection and commercial switch haul traffic received or delivered to its connections which could be obtained for a longer line haul movement via Rock Island lines. This study, referred to as the MacAnally Study, made no attempt to evaluate new traffic which the proposed new system would attract, but only traffic it presently handled with its connections in interchange. The methods followed in making the study by Union Pacific are generally described by Witness MacAnally (UP 9, pp. 15-20; UP 9A, pp. 43-62 Rev.).

According to Mr. MacAnally carloads of the same commodity moving between the same origin and the same destination via the same route were grouped together on the printouts from the traffic tapes, and all movements of two cars or more were included. The omission of single car movements was said to produce a 78% sample, which was later factored up to 100 percent to produce revenue gains. For each movement of 30 cars or more there was to be a memorandum, but due to coding differences on the original tapes, many movements were not put together on the printouts and evaluated as like movements and there was no 30 car memorandum on many such movements (MP CX-12; T. 4999). Except for the 30 car memoranda handed each opposing railroad covering that carrier's part of the traffic study, the data supplied contained no explanation for the diversion or lack of diversion. These memoranda were essentially the same for all lines (T. 5233). Mr. MacAnally on cross examination freely supplied his own reasons from the stand whenever asked (T. 4007-6349, passim). MacAnally even disagreed with the 30 car memorandum (T. 6315).

The Milwaukee analyzed the part of the study covering Milwaukee traffic supplied to it by Union Pacific and this is what it found.

The Union Pacific undertook to study only that business which it handled through Council Bluffs and Kansas City insofar as the Milwaukee traffic was concerned. It also undertook to study traffic which it interchanged directly with the Rock Island and the Rock Island excluded this traffic from its study. Union Pacific printouts of traffic data furnished to its evaluators did not reveal the name of the consignor or consignee, the type of equipment used, or the next on or off road beyond the Union Pacific's direct connection or the originating or terminating line haul carriers beyond its immediate connections. As a result, nobody on the Union Pacific was aware of movements that originated or terminated at competitive points between the Milwaukee and the Rock Island which were routed Union Pacific-Rock Island-Milwaukee or Union Pacific-Milwaukee-Rock Island. These are movements susceptible of a Union Pacific haul the entire distance, but were not evaluated (Milw. 660, p. 13).

Non-recurring movements are an important part of each year's business, but Union Pacific and Rock Island evaluators did not consider such movements as potentially divertible (Milw. 660, p. 13).

By not designating consignor or consignee, traffic routed Union Pacific-Milwaukee or Milwaukee-Union Pacific was considered to have terminated or originated at an industry served by the Milwaukee rather than at a Rock Island industry or an industry on a terminal switching line, belt line or neutral connecting line which a merged Rock Island-Union Pacific would have at least as good opportunity to solicit for a single line haul as the Milwaukee, particularly to and from Union Pacific local points (Milw. 660, p. 13).

By eliminating all one car movements, much of the traffic most susceptible to diversion was ignored. A great many of these movements would be lumber and beet sugar (Milw. 660, p. 13).

By using various groups of evaluators, who had only general knowledge from the commodity and the origin and destination state and station, who the consignor or consignee might be, the results for the same commodity from the same origin territory to the same destination territory brought wide variations in estimated diversions for no apparent reason. Even the same commodity routed by the same shipper, but from a different plant location and routed over the same carriers, received inconsistent treatment. Moreover, the first group of evaluators, in the West, were consistently overruled by the second group of evaluators, in the East, regardless of where the routing was controlled (Milw. 660, p. 13).

The most significant aspect of the Union Pacific and Rock Island studies was the refusal of the final evaluators to recognize the changed circumstances a Union Pacific merger with Rock Island would bring about. In their approach to the public for support for this merger, Union Pacific and Rock Island stressed the advantages of single line service between Twin Cities, Chicago, St. Louis, and other Rock Island points in the Midwest, and points on the Union Pacific. In their evaluation the traffic officers of both Rock Island and Union Pacific consistently refused to recognize the fact that where lines such as the Milwaukee provided through train service with Union Pacific, which is competitive to other single line routes and which Union Pacific and Rock Island have not provided, the merged system would provide at least the equivalent of our present service. Presently, Rock Island prefers the Denver, Tucumcari or Twin Cities gateways, depending upon origin and destination of the traffic, rather than Council Bluffs and Kansas City (Milw. 660, p. 14).

The Union Pacific evaluators, as did Rock Island traffic evaluators, refused to give proper weight to the very large traffic producing territory exclusively served by the Union Pacific or that of its connection, Southern Pacific, from which Union Pacific draws a large proportion of its traffic under preferential solicitation arrangements. The very strong solicitation advantage over other carriers such as the Milwaukee was largely discounted for no good reason. Union Pacific explains its low diversion estimates on the ground that shippers would want the Midwest lines as friends on rate committees. Shippers and receivers in the Union Pacific and Southern Pacific territory would have no need for a railroad like the Milwaukee to look after their interests on rate committees of the western railroads. Transcontinental rates could be established between almost any place in Mountain Pacific territory by Union Pacific singly or jointly with Southern Pacific and most major traffic producing or receiving centers in the Midwest by a merged Union Pacific-Rock Island system. If other Midwest lines join in these rates and fourth section relief is not obtained, these rates would have intermediate application and would soon spread to all points. This would become a fact whether other Midwestern lines, such as the Milwaukee, were favored with this shipper's competitive business or not (Milw. 660, p. 14).

The evaluators had no information other than the commodity to determine what effect specialized equipment or P.F.E. equipment had over the routing. Nevertheless, no consideration was given to the fact that this equipment would be routed long haul over the merged system. Before such a merger, the Union Pacific is either neutral or cooperates with the Milwaukee for loads for this equipment owned or controlled by Union Pacific insofar as Rock Island is concerned. This is an important factor regarding diversions (Milw. 660, pp. 14-15).

The evaluators all failed to recognize that with numerous Midwest junctions open for routing of general freight traffic between Council Bluffs and Twin Cities or Chicago, that traffic could be re-routed for a longer haul to either short haul the Milwaukee or to another directly connecting line competitive with the Milwaukee. Typical of this is Wisconsin traffic interchanged with Union Pacific at Council Bluffs, which could be hauled to Chicago by the merged system and then turned over to the Milwaukee or to the Soo Line. Our own study indicates that Soo Line will gain traffic in connection with Union Pacific via Chicago (Milw. 660, p. 15).

Frequently, the reason given for little or no diversion was that the routing was controlled by a national account. Milwaukee has already expressed its views on this point. However, even where the national account had expressed the view on the record in this case that its policy is to route traffic so as to give the originating carrier its longest practical haul, a very small proportion of that shipper's traffic originating on the merged system which could be handled practicably for a longer haul over its lines was rerouted in the diversion studies (T. 21886; 21892-93; 22339; 22342-43). Very little weight was given to the fact that the originating carrier has the greatest influence over the routing, the terminating carrier the next greatest and an overhead carrier the least influence, when competing with either the originating or terminating carrier for part of the haul (Milw. 660, p. 15).

It would be wholly impractical to review the Union Pacific and Rock Island studies, but a few examples will illustrate the superficial and inadequate study made, so far as it pertains to the Milwaukee's traffic covered by their studies and the work papers furnished the Milwaukee.

In the Union Pacific study, the traffic was broken down by class of traffic, i.e., interline forwarded, interline received, intermediate east and intermediate west.

(a) Union Pacific interline forwarded.

In the interline forwarded class of traffic the Union Pacific study covered 14,358 carloads interchanged to the Milwaukee which was 75.12% of 19,112 carloads of this class of traffic which Union Pacific records showed were interlined to the Milwaukee at Council Bluffs and Kansas City gateways in 1963. Union Pacific revenue from this traffic was $6,697,702 or 73.85% of the Union Pacific revenue of $9,069,866 from the total traffic forwarded to the Milwaukee at these gateways. This shows that by leaving out one car movements they failed to consider 24.88% of the carloads and 26.15% of the revenues in this class of traffic. Of the carloads studied (75.12% of the interchange) in this class of traffic, 11,296, or almost 80%, with an estimated revenue accruing to the Milwaukee of $2,100,826 was considered as potentially divertible, but only 3,162 carloads with a revenue of $656,251 were in fact taken as a gain to Union Pacific and a loss to the Milwaukee (Milw. 660, pp. 15-16).

This Union Pacific forwarded traffic is the class of traffic which Union Pacific, as the originating line, has the greatest influence for solicitation of a longer haul. Of the 14,358 carloads of this class in the Union Pacific study, 5,884 were bridged by the Milwaukee from Council Bluffs or Kansas City to eastern connections. Typical of this class of traffic is lumber. Union Pacific evaluators reviewed 2,074 carloads of lumber forwarded by Union Pacific to the Milwaukee of which 1,422 were competitive with the proposed merged system so far as the Milwaukee is concerned and could be re-routed for a longer haul from origin to destination or to a junction with a Milwaukee competitor. Of these 2,074 cars, 210 or about 10% were considered as divertible. Even on this lumber traffic going to eastern destinations, where the Milwaukee was only a line haul bridge carrier, Union Pacific evaluators used estimates varying from 0 to 75% of the movements to destinations in the same state. Of 564 carloads of lumber Union Pacific originated destined to points east of Chicago only 125 or less than 25% were considered divertible (Milw. 660, p. 16).

Potatoes represent another large segment of this class of traffic interchanged by Union Pacific to the Milwaukee. Of the 1,880 carloads of potatoes found in their study of Milwaukee traffic, only 151 carloads or about 8% were diverted. This was later changed to 10% on cross-examination. And this is Union Pacific's estimate despite the fact that of the 1,880 carloads in their study, 790 were bridged by the Milwaukee to its eastern connections. Of these 790 cars, they took 89 cars as a gain from the Milwaukee. Of this potato traffic in the Union Pacific study 565 moved to Chicago Wood Street market via Council Bluffs and 158 via Kansas City and the Union Pacific concluded they could divert only 53 of these cars despite the fact the merged company could handle the traffic to Wood Street on the same basis as the Milwaukee (Milw. 660, p. 16).

Another important commodity originating on Union Pacific and forwarded to the Milwaukee is sugar. Milwaukee was able to find 991 carloads of sugar in the Union Pacific study. There were 218 carloads from Colorado, 298 carloads from Idaho, 223 carloads from Oregon, 169 carloads from Utah and 83 carloads from plants in Nebraska, Kansas and Wyoming. Out of all of these carloads only 39 were considered by Union Pacific to be divertible to the new system. (Milw. 660, pp. 16-17).

Of the 218 carloads from Colorado only one was taken as a gain for a Union Pacific longer haul although 34 of these carloads were destined to a receiver at Muscatine, Iowa located on Rock Island trackage. Not one of the cars to Muscatine was considered divertible to the merged system despite the fact the new company would directly serve both the shipper and the receiver. One out of 68 carloads of sugar forwarded to Chicago was considered divertible. This one car from Colorado arose from the application of a 5% diversion factor to a block of 20 cars. At the same time 13 carloads received by an industry served by the Rock Island lines were considered as not divertible at all (Milw. 660, p. 17).

Of the 298 carloads from Idaho, Union Pacific concluded 18 could be secured for a longer haul. The largest movement from Idaho was a 70 car movement from McMillan to Chicago. The underlying work papers of Union Pacific contained a statement that the shipper expected to give Union Pacific a longer haul on 25% of his business, but it was then explained by a traffic evaluator that "On line deliveries to .... and ....

[receivers' names] and others will hold this to no change." No diversion from the Milwaukee on this block of traffic was taken by Union Pacific evaluators, and on cross-examination, witness MacAnally inferred that this was because the receivers were located on Milwaukee. Our investigation developed that all of this block of traffic was not to receivers on the Milwaukee in Chicago and none of these cars were destined to the receivers named in the memorandum in the Union Pacific work papers or the national account specified by witness MacAnally. This is a good illustration of the lack of information as to consignee or consignor with respect to any particular movement and how faulty the evaluators' general knowledge was of these details (Milw. 660, p. 17).

The same result was reached on the 223 carloads of sugar originating on Union Pacific in Oregon. The largest movement, 88 carloads, was from Nyssa, Oregon to Chicago. No diversions were taken because it was thought all of this movement was to an industry in Chicago served by the Milwaukee, when in fact, this was not the case. The Union Pacific had special equipment assigned to this movement and this would assure Union Pacific its longest haul (Milw. 660, p. 17).

Of the 169 carloads from Utah, the largest movement was 54 carloads from Garland to Chicago. Only one car of this movement via the Milwaukee was estimated as a gain for merged system. Here again it was simply assumed that the shipments all terminated in Chicago at industries served by the Milwaukee. The fact is that 33 of these 54 carloads terminated at industries on Chicago switching lines over which the Milwaukee would have no more influence as a terminating line than Union Pacific which would also serve the shipper (Milw. 660, p. 18).

sented 85.01% of the total interline received traffic and the Union Pacific revenue for the cars in the study 82.41% of the total revenue for all the interline received cars involved. Here again, the failure to review single car shipments resulted in no evaluation of these shipments. Probably more of these shipments would be susceptible to diversion than many multiple car movements. Of the cars in the study 6,573 were those on which the Milwaukee was only a bridge carrier and the Union Pacific the terminating carrier, but despite their influence as the carrier serving receiver at destination, their diversion was minimal (Milw. 660, pp. 18-19).

Our study of the Union Pacific printout sheets for its interline received traffic interchanged by the Milwaukee revealed some very unrealistic evaluation by the officers in charge of the diversion study. For example, on cars originating in Wisconsin on our line destined Union Pacific stations, both local and competitive with other lines, out of a total of 878 cars, the evaluators concluded Union Pacific would divert only one car, even though all of this business could be lost by us at the Chicago gateway. On cars originating in Chicago proper, including industries on many different lines, they indicated they would divert only 98 cars out of a total of 1,618 cars, even though this business would be local traffic if moved via the merged system and Union Pacific car supply at Chicago would be an important factor (Milw. 660, p. 19).

(c) Union Pacific interline intermediate—westbound.

With respect to Union Pacific interline intermediate traffic—westbound, the Union Pacific underlying papers indicates there were 13,811 cars received from the Milwaukee in their records which yielded the Union Pacific revenue of $6,155,977. They reviewed 10,722 cars (77.63% of the total) with Union Pacific revenue of $4,724,798 (76.75% of total revenue) and concluded that while they had a potential of 3,665 cars with estimated revenue value of $553,750 to the Milwaukee they could divert from us only 413 cars with estimated revenue value of $60,412 annually, despite the fact that for 4,737 carloads in the study, the Milwaukee was also a bridge carrier. Much of this traffic bridged by Union Pacific terminated on Southern Pacific and was subject to the prevailing preferential solicitation arrangements (Milw. 660, p. 19).

Our study of the printout sheets for this class of business disclosed that of 559 cars in the study orginated in the State of Iowa, there were 300 carloads originated at common points with the Rock Island, on which the traffic evaluators of the Union Pacific concluded they could only divert 26 cars with a revenue to the Milwaukee estimated at $2,774 per year. While we, like the Union Pacific traffic evaluators, did not have the benefit of information as to the shippers and receivers for the cars shown in the Union Pacific printout, there is no doubt but that many of the shippers at the common points in Iowa were located on the Rock Island and to consider that on only 26 cars the shippers would give the merged system traffic they can originate and handle to Ogden or some other western connection, is rather ridiculous (Milw. 660, pp. 19-20).

The situation with respect to traffic originating on our line in Illinois is also unrealistic. There were 3,277 such carloads in the printouts; 3,039 were of a competitive nature as between the Milwaukee and the Rock Island. The Union Pacific concluded only 87 cars with revenue value of $14,293 would be diverted (Milw. 660, p. 20).

Shipments originating on our line in Minnesota and Wisconsin were apparently also given little attention as the diversions were very insignificant although in many cases the Rock Island either served the origin or a junction point with our connection. As transcontinental rates and routes from points in the Midwest are generally open east of the Missouri River gateways via all carriers party to Trans-Continental Freight Bureau Directory 5 Series, the gains taken by the Union Pacific appear deliberately held to a bare minimum (Milw. 660, p. 20).

(d) Union Pacific interline intermediate—eastbound.

Our analysis of the Union Pacific's printout sheets for its interline intermediate—eastbound business disclosed the traffic in this class interchanged to the Milwaukee amounted to 18,571 carloads (70.52% of the total traffic of 26,334 cars) with Union Pacific revenue of $6,171,084 (69.90% of the Union Pacific's total revenue of $8,828,591). With almost 30% of the traffic one car shipments and not available for review, it is plain a very important segment of the business was not analyzed. This class of traffic is highly susceptible to influence by the Union Pacific and its western connections. This is traffic on which the Union Pacific has a tremendous amount of influence due primarily to its preferential solicitation agreements with the Southern Pacific and its ownership in the Pacific Fruit Express Company, yet they found that only 14,697 carloads with Milwaukee revenue estimated at $1,798,019 were potential for longer haul over the merging lines and only 3,120 carloads with Milwaukee revenue estimated at $330,469 per year would actually be diverted from our handling. The Milwaukee was also an intermediate carrier on 9,827 carloads of this class in the Union Pacific study (Milw. 660, p. 20).

Our study of the printouts indicated that lumber was the most substantial movement. Most of this originated on the Southern Pacific. Of the total carloads in this class, 5,100 were either lumber or plywood, and while the Union Pacific considered 1,328 carloads as potentially divertable, they took a gain on only 145 carloads. Out of the total of 5,100 carloads, 1,188 were destined to points in the Midwest and the Union Pacific considered 56 divertible. The preponderance of the lumber traffic, 3,912 carloads, were destined to points in states east of Chicago where the merger will offer a long line service from far western junctions to direct connection with eastern lines in competition to the Milwaukee as an additional bridge carrier between Council Bluffs and Chicago, yet the Union Pacific only regarded 89 cars as divertible (Milw. 660, pp. 20-21).

Union Pacific evaluators made their evaluations between October 7 and November 13, 1964. According to the instructions a plus mark was placed on each movement considered a potential for rerouting (UP 9A, p. 48). When all of these plus marks are added up they produced revenue gains from Union Pacific commercial line haul traffic only of $59.7 million (Milw. CX-1; T. 5155-59). This is what Union Pacific evaluators thought it was likely to gain from all of its connections (T. 4570; 4996-99). This more nearly represents what Union Pacific traffic evaluators expected if it had not been decided to disavow this result. But for a final evaluation this was reduced to a mere $15,309,306 (Milw. CX-1). Compare this low estimate of actual gains with the estimates made by Union Pacific in its 1960 traffic study, a lower traffic year than 1963, where it was concluded that $228 million was losable to a Rock Island-Union Pacific combination by its eastern connections at the Missouri River.

The total gain on Union Pacific line haul traffic as thus reduced and first revised was $15,020,306. To this was added commercial switch haul traffic and company material traffic to be gained for the merged system producing a total revenue gain from other railroads on Union Pacific traffic of only $16,780,303 (UP 9A, p. 62 Rev.). The Milwaukee's loss of Union Pacific commercial line haul traffic was only $1,413,535, slightly less than 10 per cent of the total for all lines. The Union Pacific study of switch haul traffic switched to connections at Omaha and Kansas City is no study at all and admittedly is just plain wrong (T. 45430-31).

2. Rock Island's Traffic Study does not even Purport to Give Effect to Union Pacific's Traffic Solicitation Advantage.

The Milwaukee also examined the work papers underlying Rock Island's traffic gain study and it found this study to be so grossly understated as to be ridiculous.

The testimony of the Rock Island traffic witness, the printout sheets and other information we were able to obtain from the Rock Island as papers underlying their study of traffic interchanged with the Milwaukee indicated they had concluded they would only be able to divert from the Milwaukee traffic yielding revenues estimated at $2,828 per year. This diversion figure represented $732 on 12 carloads of Rock Island interline received traffic; $1,408 on 4 carloads of interline forwarded traffic; $34 on 3 carloads of interline intermediate traffic-eastbound and $654 on 4 carloads of interline intermediate traffic-westbound. It is impossible for us to determine just how many of Milwaukee cars were in the Rock Island studies, because they were intermingled throughout their various record books with the traffic of all other connecting lines. After the hearing started we were favored with a revised estimate of their gains and our losses together with a printout showing only the relatively few cars out of the thousands interchanged between the Milwaukee and the Rock Island that Rock Island evaluators considered as susceptible to diversion and the negligible number of cars they regarded as actually divertible (Milw. 660, p. 21).

While, as mentioned, it was practically impossible for us to obtain complete information on all cars interchanged with the Milwaukee that were reviewed by the Rock Island, we were able to make the following tabulations:

As to Rock Island interline received traffic received from the Milwaukee on the Rock Island study, of which there were at least 287 cars, 108 originated at points common between the Milwaukee and the Rock Island, 31 from points where the Milwaukee and Rock Island could participate via a competitive junction, and 148 from points common between the Milwaukee and Union Pacific. The traffic evaluators concluded they could only divert 12 cars. Not one of the 148 cars from Milwaukee-Union Pacific common points that could be handled by the Union Pacific-Rock Island from origin to destination was considered as divertible (Milw. 660, pp. 21-22).

With respect to Rock Island interline forwarded traffic we calculated there were at least 628 cars interchanged to the Milwaukee in their study. The Rock Island traffic people considered only four cars as divertible; three cars of manufactured iron and steel articles from Rock Island, Illinois to Aberdeen, Washington and one carload of vehicle parts from Rock Island, Illinois to Seattle, Washington all moving via the Twin Cities gateway in competition with Union Pacific's Council Bluffs route (Milw. 660, p. 22).

As to Rock Island interline intermediate-eastbound traffic, we were able to tabulate 3,570 cars interchanged with the Milwaukee in their study. Included in the study was one movement of 60 carloads from Gregory, Texas received by the Rock Island at Fort Worth, Texas and delivered to the Milwaukee at Omaha, Nebraska for movement to Longview, Washington. The Union Pacific serves the destination and, while one of the Rock Island traffic evaluators had indicated the opinion that Rock Island should be able to get at least a portion via the merging lines long haul, there was no diversion whatsoever taken as a terminating carrier (Milw. 660, p. 22).

The preponderance of this class of traffic was competitive in nature as between the Milwaukee and the Rock Island and, whereas most of the business interchanged between Rock Island and the Milwaukee was received from Southern Pacific, the merged system will have the benefit of ownership in the P.F.E. to assist them on the many cars of perishables involved. It is difficult to understand how they could possibly come up with only three carloads as being susceptible to diversion (Milw. 660, p. 22).

With regard to Rock Island interline intermediate-westbound traffic we developed there were at least 3,004 cars interchanged with Milwaukee in the study. There was a very substantial amount of competitive traffic involved in this category which could be re-routed for long haul of the merged company and it is difficult to understand how the Rock Island traffic evaluators arrived at the conclusion that they would only be able to divert two cars of paper and paper articles from an origin in New York state to a California destination and two cars of chemicals from a New York state origin to an Oregon destination (Milw. 660, p. 22).

These two studies combined predict a revenue gain to Union Pacific-Rock Island of $19,825,447 from all lines in case of full merger and $16,823,115 in case of sale of the southern segment of Rock Island to Southern Pacific. The Milwaukee's loss is shown as $1,415,915 in the one case and $1,415,014 in the other (UP 4A, Study 8 Rev.; UP 4B, Study 8 Rev.).

On rebuttal these estimates were revised upward slightly to $20,318,946 per full merger and $17,327,451 with sale of southern segment to account only for the specific errors in the study admitted by witness MacAnally on the witness stand. Obviously, this revision does not reflect the total disagreement between the opposing railroads and witness MacAnally which we have summarized above (Joint brief, pp. 251-52).

3. The Milwaukee's Traffic Study is a Very Reasonable Estimate of the Effect that a Union Pacific-Rock Island Merger would have on Milwaukee Traffic.

The Milwaukee from the beginning decided to rely on its own evaluation of the impact of a Union Pacific-Rock Island merger. It began its study early in 1965 from 1964 traffic tapes. It decided to use all movements from each of four months of the year after satisfying itself that this would be representative of the traffic handled by the Milwaukee for the full year (Milw. 660, pp. 2-3).

The Milwaukee's four-month traffic printouts showed all information which would be useful in evaluating the movement, full route of movement in most cases, consignee, consignor, type of cars, etc. Like movements were combined. Movements were segregated by class and by direction and flow of traffic and then segregated in sub groups and classes to refine and group together those having the same diversion characteristics. With respect to certain groups of traffic a color code was used to show factors which would influence a diversion or no diversion. This color code was later converted to a digit code and it and all work books were furnished to the interested parties and filed with the Commission as Milwaukee Exhibits 680 through 689.

It should be noted that in making the final evaluations as to merger it was assumed that all existing routes and rates would remain in effect and no new routes and rates had been established after merger, and most importantly, that, except for the improved interchange as between Union Pacific and Rock Island lines to that equal to interchanges with the Milwaukee, the Milwaukee's train service, interchanges and terminal handling for all connections, via all routes and junctions in which it participates would remain as competitive after a Union Pacific-Rock Island as they were at the time of the study. It was also assumed that Milwaukee's pre-blocked through train arrangement with Union Pacific at Council Bluffs remained unimpaired (Milw. 660, pp. 6-7).

These assumptions were made so that the study would only measure the impact of the Union Pacific-Rock Island merger on Milwaukee's traffic without taking into account further losses which might occur if operations were curtailed to offset reduced earnings.

The Milwaukee study not only covered traffic interchanged with Union Pacific and Rock Island, but also covered other Milwaukee traffic which neither of these carriers participated in but which the Union Pacific-Rock Island would compete for after merger.

When expanded to a full year, Milwaukee's study of traffic interchanged with other western carriers, moving to and from the western states via Twin Cities and

Missouri River gateways, shows that 120,837 carloads of its traffic or 45 percent of this interline traffic was susceptible to movement via the Union Pacific-Rock Island lines for new or longer haul. The Milwaukee's revenue from this traffic was $23.3 million. It estimated a loss on 26,280 carloads reducing the Milwaukee's revenue by $4,264,470. This is under 22 percent of what the Milwaukee could lose and is well within the area of what Mr. Wyer agrees is reasonable (UP 9, p. 9; CNW CX-13, p. 13; T. 1763). Compare this with Union Pacific evaluators first estimate in its 1963 study showing a loss on this category of traffic of $5,954,849 (Milw. CX-1).

The Milwaukee also examined its other interline traffic and found that 15 percent of this class of traffic was susceptible to diversion to a Union Pacific-Rock Island system. It estimated that 1.2 percent of its other interline traffic or a modest 7.4 percent of the losable traffic in this category would be actually lost (Milw. 660, p. 12).

In addition, the Milwaukee examined its local traffic. It found that 14 percent of its local traffic could be lost to the competitive single line system of Union Pacific and Rock Island, but that only 1.2 percent of this class of traffic would actually be diverted. This is only 8 percent of the pool of traffic which could be lost were the Milwaukee's competitive position otherwise impaired (Milw. 660, p. 12).

While there are many methods and procedures for making traffic studies, there is general agreement as to the criterion which influences a shipper's routing. They all must deal with those competitive factors daily to stay in business. Primarily this is service, but where services are competitive less intangible factors appear. In the end this all boils down to the importance of one railroad over another to shipper or consignee designating the routing. Traffic volume itself is an indication of relative importance in the overall of our railroad over another to shippers generally. But more importantly traffic volume governs service as well. The greater the volume the more frequently trains can be assembled, scheduled and run (Milw. 660, p. 8).

By any reasonable standard, the Milwaukee's estimate of loss is a conservative measure of impact of a Rock Island-Union Pacific merger upon Milwaukee's traffic. This estimate would not materially change if Milwaukee were merged with North Western (T. 34976-79).

Nothing offered by Mr. MacAnally on rebuttal in any way detracts from this Milwaukee study (UP 1064, pp. 34-35). Much of what is said by him confirms Mr. Cullen's methods (T. 45336-39). Such criticisms as were made on rebuttal simply demonstrate a cursory and inadequate knowledge of the study made and the subject matter covered by the study (T. 45340-89; 45632-33).

The Milwaukee's study when compared with the Union Pacific's study demonstrates that the Union Pacific-Rock Island estimate of traffic gains are grossly understated.

D. Traffic Gained Under The Union Pacific Merger Proposal Will Increase Rather Than Decrease The Social Cost Of Excess Capacity.

1. Wyer Incremental Cost Studies.

The methods used by Wyer in determining the cost of handling for the traffic gains estimated by Rock Island and Union Pacific and the corresponding losses by other lines were brought out in the record through cross examination (T. 2840-2917). He used selected system expense items which he deemed to vary with traffic volume and separate variability factors for different expense items (T. 2894-96; UP 1043, App. A.). For car expense, other than tank and refrigerator cars, he used Union Pacific's per diem experience whether the cars were per diem cars or not. He arrived at car costs by assuming car days required for the cars rerouted based upon his own judgment. He judged that there would be one day of expense for each 500 running miles regardless of whether the car came on and left a railroad within 24 hours without accruing per diem. He used two days to load and two days to unload and one day to place the car in the train and one day to take it out of the train, and one half day for each interchange. He used Union Pacific's experience for empty car ratios for all carriers.

Wyer used one half of a terminal expense for each interchange whether or not the traffic moved through interchange points in run-through trains, and this he defended vigorously. But when he came to estimating added interchange costs arising from the division of Rock Island between Union Pacific and Southern Pacific, he did not follow his incremental theory, explaining that this added cost of the interchange was reflected in reduced savings available at Kansas City because of split of Rock Island as shown by the difference in savings in Exhibits 4A and 4B. He explained then, this was perfectly all right because he had studied actual operations at Kansas City, and it was planned to have a run-through arrangement between Southern Pacific and Union Pacific at Kansas City and this was all reflected in reduced operating savings (T. 2871-86; 3551-56). We simply point out that Wyer is very flexible in his treatment of costs.

The use of system expenses and his methods had no relation to the traffic involved or the methods of handling it. Thus, for the Milwaukee the costs of handling traffic to be lost is 57.14 percent of the revenues and 65.26 percent for North Western compared with 45.88 and 36.61 percent for Burlington and Great Western, respectively (UP 1043, App. B). It does not appear that Milwaukee and North Western may have a larger proportion of traffic estimated to be lost which originates and terminates on line than either Burlington or Great Western. It is clear that by using system average costs, Milwaukee and North Western's cost of handling include their very substantial way and branch line service where the costs per service unit are higher although the bulk of the traffic to be lost according to Union Pacific's estimate, is traffic moving between Chicago and Kansas City or Chicago and Council Bluffs-Fremont, which moved either overhead or terminating on line (T. 44927-30; Milw. CX-1).

On the other hand Wyer used Union Pacific costs in estimating the added cost of handling the Union Pacific's traffic gains thus reflecting Union Pacific's heavy proportion of high density main line operations (UP 4A and 4B, Study 8). Why the Milwaukee should have a decremental cost of 57.14 percent of revenue and a Union Pacific-Rock Island an incremental cost of 40.3 percent of the same revenue is simply unexplainable and shows how very wrong his incremental average system cost data is.

2. The Milwaukee Relievable Cost Study.

The Milwaukee made its own cost study of the traffic it estimated would be diverted and hopefully to avoid unnecessary differences of opinion, adopted Wyer's cost finding technique and methods where there was no cause to disagree. The difference in methods between the Wyer method and the Milwaukee study are shown in Mr. Wyer's rebuttal Exhibit (UP 1043, App. A). However, the Milwaukee's study presented by Mr. W. K. Hettinger was made to reflect relievable costs of the Milwaukee and therefore more closely related to the segments of line and train service involved in the cars to be lost as found from Milwaukee's traffic diversion study.

The Milwaukee's cost study was based upon an operating study made by Mr. Garelick, a Milwaukee operating officer, as to how the railroad would adjust train operations of its various subdivisions over which the diverted traffic moved in the event the estimate volume of traffic was lost on a day in and day out basis (Milw. 691, pp. 6-8). Based upon this experienced operating judgment, which took into consideration service requirements and the necessity for remaining competitive as well as the need to reduce operating costs, train expenses and crew wages were accordingly adjusted by Mr. Hettinger to reflect the savings in costs of handling to an actual basis. In addition his costs reflect the actual expense of the Milwaukee for the lines and services involved including terminal services as distinguished from the system average expenses where this information could be isolated. The Milwaukee excluded return on investment on locomotives and cars (Milw. 693; Milw. 931, pp. 2-3).

On rebuttal Mr. Wyer took Mr. Hettinger's study to task on two major features, i.e.: the fact that the Milwaukee study attempted to relate diverted traffic to particular train and switching operations in developing train and yard service costs, as above related, and the fact that the Milwaukee study did not include return on investment in locomotives to be eliminated or cars not required after the estimated traffic is lost (UP 1043, pp. 34-39; T. 44920).

As Mr. Hettinger said, "return on investment is not a relievable cost" (Milw. 931, p. 3). The simple fact is that return on sunk investment is an expense found in net railway operating income for any particular year. On cross examination it was pointed out that in Wyer's own reports on the economics of merger, he only used a return on the net salvage or depreciated value of locomotives released where reductions in service were shown, not average system original or replacement cost as contended by Wyer in making cost studies (UP 4A, 4B, Study 1 and 2; T. 44974). This salvage value was an offset to net cash required upon which a return was properly added. Obviously, for the long term, traffic permanently lost will not require engines and cars to be replaced, but when it is intended to reflect the effect of the loss in a pro forma income statement for the study year return is already in the net railway operating income. This is not a large item of cost. The real point to be made is that in measuring incremental costs for increased business adding a rate of return on equipment is proper to reflect the added fund requirements for the added equipment, but in measuring relievable costs, return on the sunk investment is reflected in net earnings.

The Milwaukee examined its operations and concluded what train service it might reduce or eliminate and reduced crew wages and train expenses accordingly. Mr. Wyer insisted this was not proper because these incremental costs always vary with gross ton miles. His explanation was that at some time some place trains will not be run because of decreased carloads and in the long run reduced ton miles caused by traffic diversions will bring about a like reduction in train miles. To illustrate this Wyer referred to the experience of the MKT before Mr. Barriger took over where ton mile and train mile costs paralleled each other (T. 44936-49; T. 45131-32).

But even Mr. Wyer in his reports on the economics of merger when estimating savings from the elimination of train operations (Study 2) and consolidation of terminals (Study 1) or increased volume for lines retained (Study 3), used the very cost tracing efforts he criticized the Milwaukee cost study for doing (T. 44943-58, UP 4A, 4B and SP 4K). In the end Wyer agreed that so far as crew wages and train expenses it is possible to establish these costs on a simulated basis if a study were made (T. 44959-60). Mr. Garelick made such a study which is the basis for Mr. Hettinger's costs for crew wages and train expenses.

The conclusion is that the Milwaukee's cost study reasonably reflects the costs that it would be able to relieve itself should the Milwaukee lose the modest amount of traffic diversions it has estimated and still maintain competitive service.

But this does not mean that the Union Pacific would be able to handle the traffic diverted from other carriers at the same cost the losing carriers would be able to save. There is a minimum below which it is not possible to go in reducing service to meet permanent traffic losses if they are to remain competitive and not lose additional traffic to improvident service reductions.

3. The Difference Between Relievable Costs and Incremental Costs Represents the Added Social Cost of Traffic Diversion.

Mr. Hines, a witness for Kansas City Southern, expressed the view that where the carrier losing the traffic is operating at substantially below capacity and the carrier gaining the traffic is operating near capacity so as to require increased plant and equipment to handle the traffic gain there is an increase in the total cost of handling for all carriers involved. In other words, where the losing carrier cannot reduce service below a "bare bones" minimum without losing traffic, those cost elements which vary with reductions in traffic are fewer than those which are incurred by the carrier gaining traffic, particularly when the latter is gaining traffic from a number of other connections (T. 26053). As Mr. Hines so aptly put it:

> "Q. That's right. Now, and this would also depend on the volume of traffic that would be diverted to the gaining line, wouldn't it, if there was a very substantial increase in traffic on the gaining line from a number of carriers, for example, and a loss of some amount to the losing line, then you would have more incremental costs on the gaining line than you would be able to eliminate on the losing line."
>
> "A. I would like to rephrase that so we see if I understand it. If these fingers (indicating) represent five railroads, and this one railroad over here (indicating), which is the arm, which is gaining all the traffic, and these five roads out here (indicating) are the ones that are operating at bare bone or less than plant capacity, yet this one railroad (indicating) is operating near plant capacity, to answer your question, yes."
>
> (T. 26056-57)

The Milwaukee attempted to assess this difference by showing that its relievable costs were $2,851,384, whereas using Wyer's formula for handling the same traffic over the same lines of the Milwaukee the cost would be $3,727,836. This difference of $876,452 reflects the added costs only in connection with Milwaukee's estimated losses, but it is what the Milwaukee would have to absorb or pass on to the public through reduced service.

This illustrates how diverting traffic from one line to another can result in added social costs unless all competition for traffic is to be completely disregarded. If the latter is the course to be followed even more traffic can be expected to be lost as was the sad experience of the MKT before Mr. Barriger took over. He said his predecessors were "the most efficient people in the United States whoever starved a railroad into prosperity." (T. 26096)

Of course, if there were substantial economies in operating costs of the merging lines which beyond question would more than offset this increased total cost of handling rail business by all lines, as in the CM&NW proposal there would be no question of added social cost. But after considering the entire merger program of Union Pacific where there are no offsetting savings, and which involves increasing investment in equipment and plant to generate the traffic, there is a very real probability that total rail transportation cost will increase, giving due regard for the competitive world in which all railroads must survive.

E. Union Pacific's Proposal Offers No Compensating Public Benefits.

1. Union Pacific is at No Competitive Disadvantage Because it Must Rely on Midwestern Connections.

The Union Pacific set out in the early stages of this case to prove that by virtue of the fact the Union Pacific must rely on their east end Missouri River connections it was at a competitive disadvantage. Further, that its operations must be extended to Chicago and St. Louis to eliminate the need to rely on the asserted unreliable service of the Midwestern carriers and be able to provide new single line service to connect with the merging eastern carriers. The attempt of the Union Pacific to prove this was a complete failure. What was proven was that the present Midwestern carriers are providing excellent service in connection with the Union Pacific and that the proposed single line service would be no improvement over present joint line service. It was also clearly established that the merger of Midwestern carriers would provide more run through train operation in connection with Union Pacific than Union Pacific would provide over its lines to Chicago and St. Louis if the merger were approved, provided the diversions of traffic were no greater than is asserted by Union Pacific. The merger of Midwestern carriers would, however, provide the definite possibility of complete run through transcontinental trains with eastern carriers.

The Union Pacific in attempting to prove its competitive disadvantage in the transportation of traffic between the territory east of the Missouri River and Mountain Pacific Territory asserted that the transcontinental schedules had been speeded up "and some of our eastern connections were already having difficulty meeting them." (UP 1, p. 12) Further, that the Union Pacific's handicap was in not having direct access to the Illinois gateways of Chicago and St. Louis. The testimony of the Union Pacific which then attempted to demonstrate the connecting carrier failures was introduced by witness E. M. Prouty (UP 12, 12A). A study was made of the performance of the principal through route connections of the Union Pacific at Freemont, Grand Island, Council Bluffs and Kansas City. It showed the delivery times of westbound trains at the interchange points by the various connections and the Union Pacific's time of delivery of trains eastbound at the same junctions. The Union Pacific conclusions from the study were that westbound trains were being delivered late to them while they were making deliveries to the eastern connections on time. The approach of the Union Pacific was meaningless and the study proved nothing as it looked blindly at one point of interchange and not at the overall performance of the trains on the lines of the connections and on the Union Pacific (Milw. 691, p. 4, App. MG-3). The Union Pacific witness admitted that the overall train performance was the important factor (T. 45231).

To demonstrate that Union Pacific east end connections are performing more than adequately and that Union Pacific is not competitively disadvantaged by the Missouri River interchange will not take a detailed review of the record. Many of the Union Pacific connections either operate through trains with the Union Pacific at their respective junctions or tender, in Union Pacific's terminology, pre-blocked cuts of cars (UP 12; UP 1053; Milw. 691, p. 4; T. 45262-63; 45266-67). The various minor differences in whether the trains go through without or with power or are considered by Union Pacific as only a pre-blocked cut of cars is in the final result meaningless. The Burlington's trains via Grand Island, the North Western's trains via Freemont and the Milwaukee's pre-blocked cuts of cars, now combined with Rock Island traffic westbound at Council Bluffs, are all competitive with each other in the handling of business from and to Chicago on the one hand and Mountain Pacific Territory on the other (T. 856; 959-60; 45230).

The evidence that the east end connections service is as good or better than that which the Union Pacific proposes comes from the witnesses for the applicants.[28]

> Witness Bowen of the Union Pacific conceded the Union Pacific train service after merger with single line service would be about the same as the present handling of the Milwaukee and Rock Island traffic. The only difference would be that the Rock Island's train would run through adding the Milwaukee traffic to the blocks in the train at Council Bluffs. Today, the reverse is true, the Rock Island traffic is added to the Milwaukee's train (T. 45240-41).
>
> Witness MacAnally testified that the Union Pacific-Rock Island single line service to and from Chicago would be no faster than that of the present joint line service (T. 45513).
>
> Mr. Langdon felt that the single line service of the merged company would not provide any better service than the existing joint-line through train service (T. 9922-23; 9929).
>
> Dr. Ernest Williams found no advantages of single line service over the handling of traffic that is being interchanged in a pre-blocked fashion (T. 12044-45).

In the final analysis the Union Pacific did not assert that single line service would bring about any major improvements in rail transit time. It was admitted that all they would have is single line service which might not change anything (T. 45241). Any supposed benefits of single line service were in the area of better car tracing, reconsignments in route, the handling of damage claims and other minor matters which are not of sufficient importance to be the grounds for a merger of this magnitude (UP 2, pp. 6-7; UP 9, p. 29; UP 12, pp. 14-15). *Chicago, B & Q R. Co., Control,* 271 I.C.C. 63, at page 150.

[28] Additional references similar to those following (T. 995; 1127; 5150; 5583).

We have previously pointed out that in railroading the benefits of single line service are not of prime importance in providing through service. Under the Act the railroads historically have been required to interchange equipment with each other and maintain through routes and rates.[29] Under this system of transportation the movement of trainloads is the key factor of importance and if two end to end connecting railroads are able to generate sufficient tonnage between points on one railroad to the points on the other and through train operations instituted the interchange between railroads is not significant and service is tantamount to single line service (Milw. 691, p. 4; CNW 612, p. 31). Today the Union Pacific with its cooperating connections participates in numerous through train operations (CNW 571; UP 12A; UP 12, p. 4, p. 10; T. 45266-67).

If it is assumed that Union Pacific will only divert from its Missouri River connections the traffic it estimates it will gain under its 1963 traffic study, Union Pacific will handle via its single line route over the lines of Rock Island east of Council Bluffs, a daily average of 123 loaded cars eastbound and 78 cars westbound. This includes present Rock Island traffic plus what is expected by Union Pacific to be diverted from other connections at the Council Bluffs gateways. This is the equivalent of one through train in each direction on a daily basis (Milw. 691, p. 12; T. 45232-41). If Union Pacific is permitted to extend operations beyond its historical Missouri River gateways, according to its own evidence there would be produced no improvement in service. On this basis, its service across Iowa on the Rock Island lines would approximate that of the Milwaukee and its operating characteristics would be approximately the same.

[29] 49 U.S.C. § 3.

The result of diversion to Rock Island lines would be that Milwaukee's already thin volume, as well as that of all of Union Pacific's other Missouri River connections would be that much less.

By way of contrast, permitting a combination of the traffic of CM&NW and Rock Island would go a long way in increasing and improving the through train operations. As an example if the Milwaukee, North Western, and Rock Island were combined, the average daily interchange of these carriers with Union Pacific would be 443 cars per day eastbound and 259 westbound without diverting traffic from anyone (Milw. 691, p. 13).

Merger of these Midwestern lines would provide a sufficient volume of traffic moving between the merging lines and Union Pacific to establish several through trains daily. A merger of these Midwestern lines would improve train service and reduce costs by reducing the train switching and terminal services required on a greater volume of traffic than would be possible under separate operations. With this volume of traffic available, run-through trains could probably be instituted in connection with recently combined eastern railroad systems at Chicago. Such a Midwestern system together with the Union Pacific and eastern railroads would combine an adequate volume of carloads to perform the most efficient and economical through service. With the reduced combination of connecting carriers to whom deliveries must be made, expensive switching and transfer operations at terminals would be reduced (Milw. 691, p. 13). If the Union Pacific-Rock Island merger formed a route to Chicago with its estimated volume of cars per day, it would not have sufficient cars moving to the eastern carriers for a through train operation (T. 5150).

2. The Milwaukee Extension to Portland does not Justify the Line Extensions Sought in this Case.

In this proceeding numerous carriers are seeking extensions of their lines by merger or by requesting trackage rights or the purchase of other carriers' lines. Examples of carriers seeking such extensions are Union Pacific, DRGW and KCS. We wish to express a word of caution that the Milwaukee extension to Portland cannot be used as precedent to justify these requests.

The carriers seeking to extend their lines can all now solicit traffic for movement over their lines and receive their maximum haul and interchange such traffic at gateways freely with their connections. They can presently reach through their eastern connections all points they seek to reach and receive their long haul.

The Milwaukee, because of tariff rate and routing restrictions, could not solicit traffic for its long haul over the lines of its railroad west of the Twin Cities traffic terminating on foreign lines in the Pacific Northwest (T. 3822). On the Milwaukee, the free movement of transcontinental traffic and north-south traffic on the Pacific Coast was restricted.

The Commission found that there were artificial barriers to the free movement of traffic on the Milwaukee. On this basis the relief was granted. Similar conditions do not prevail on any of the lines seeking extension in these proceedings. *Great Northern Pac. & B. Lines merger Great Northern,* Recommended Report served August 24, 1964, and 331 I.C.C. 228.

3. Union Pacific Proposal will not Reduce Terminal Congestion or Costs at Major Traffic Gateways.

A normal result of mergers is to reduce the number of interchanges which must be made between carriers. This reduction by one interchange occurs at common terminals and junctions. The reduction of interchanges not only occurs between the merging carriers but also for all of the connections of the merging carriers at the junction.

For example, at Omaha-Council Bluffs the merger of Rock Island and Union Pacific eliminates the interchange between the two carriers and reduces by one the interchange it and connecting carriers must make (T. 66; 119). The savings to the merging carriers are normally reflected in their economic studies (UP 4A, Study 1; CNW 1148, Study 4). There is, of course, a savings to all of the connecting rail carriers at these common junctions. The cost savings of the connecting carriers are not reflected in any reports but are reflected in the benefits to the industry generally and to the public in more economical transportation.

An end to end merger produces fewer of these benefits. In a Union Pacific-Rock Island full merger, such savings would accrue to the merging carriers and other carriers only at major gateways where traffic is interchanged at points common to the merging carriers, points such as Omaha-Council Bluffs, Kansas City and Denver.

At the points to which service is extended by the end to end merger, no benefits in cost reduction through elimination of interchange or elimination of congestion in terminals occurs. For example at Chicago, St. Louis and Minneapolis-St. Paul the same number of interchanges with connections must occur. The Union Pacific is merely substituted for Rock Island. At Minneapolis-St. Paul, the Northern Lines and CM&NW will not benefit by a reduction in the number of interchanges to be made. Likewise at the major eastern terminals, St. Louis and Chicago, to which the Union Pacific seeks to extend, there is not benefit of merger to the connecting eastern or southern carriers (T. 5150).

We have here again an example of how the merger of parallel and duplicating lines increases the benefits of merger not only to the merging carriers themselves but to all of their connections at the common terminals. Even under control the possibility exists to eliminate costly interchanges (CNW 1148, Study 4). At every major gateway where traffic is interchanged these benefits are available. The major gateways and common terminals where Rock Island and CM&NW operate are Chicago, St. Louis, Kansas City, Des Moines, Minneapolis-St. Paul, Council Bluffs-Omaha and Peoria.

At these points real savings are available not only to the carriers directly involved but to all connecting carriers at these junctions. Not only can real savings be made in the cost of carrier to carrier terminal transfers, but the number of blocks which carriers must make on line for connections can be reduced with corresponding reductions in switching cost. Intratrain and interterminal switching would be reduced. The congestion caused by numerous terminal transfer movements is reduced (Milw. 691, p. 13).

The public benefits of a CM&NW-Rock Island combination in this area alone would be monumental. On the other hand the same benefits are not available through a Union Pacific-Rock Island merger. The benefits of a Union Pacific-Rock Island merger in this area are almost non-existant.

When the entire proposal of the Union Pacific is considered the benefits of reduced interchanges completely disappear. A split of the Rock Island at Kansas City and sale of the south half to Southern Pacific leaves the number of carriers for interchange the same on east-west traffic and increases by one the number of interchanges to be made on north-south traffic (T. 905; 2872-73). Upon sale of the Rock Island western lines to the Rio Grande the number of interchanges at the Missouri River junctions remain the same. The Union Pacific proposals in this regard maintains status quo without public benefit or any step toward reducing terminal congestion or costs.

4. The Union Pacific and Southern Pacific Disregard for Efficiency in Transportation is Further Evidenced by the Proposed Disposition of the Rock Island Motor Transit Company.

A wholly owned subsidiary of the Southern Pacific, Southern Pacific Transport Company, filed its application in these proceedings to purchase the southern half of the Rock Island Motor Transit Company, the wholly owned motor carrier subsidiary of the Rock Island.[30] The attempted disposition of the motor carrier rights of the Rock Island Motor Transit Company again evidences the Union Pacific's and Southern Pacific's lack of thought or concern for the public interest.

We have described previously how Union Pacific and Southern Pacific agreed to dispose of the Rock Island in order to maintain their dominance in rail transportation and to enhance their natural spheres of influence (CNW CX-2). The handling of the valuable motor carrier rights again demonstrates the tactics of the Union Pacific and Southern Pacific in completely disregarding any thoughtful approach to the problems of public interest and indi-

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[30] *Southern Pacific Transport Co.—Purchase (Portion) Rock Island Motor Transit Co.,* No. MC-F-9222.

cates the overriding concern was with their own self interest.

The Rock Island Motor Transit Company has extensive unrestricted motor carrier operations throughout the Midwest from Chicago to Omaha, through Des Moines to Kansas City, through Oklahoma City to Dalhart, Texas. The carrier also has auxiliary and supplemental motor carrier authority paralleling the Rock Island lines south in Oklahoma, Texas and Arkansas (SPT Application Ex. B; T. 14810). In disposing of these rights, the Union Pacific and Southern Pacific solution to the problem presented was to cut the Rock Island Motor Transit Company's rights and operations in half without regard to the public use of these rights. No evidence was presented as to the type and kind of shipments handled by the Rock Island Motor Transit Company and the extent of the through movements between the points north of Kansas City and points south of Kansas City. This was evidenced by the failure of the Southern Pacific Transport to present with the application, a B7 exhibit (T. 14812-13). The extent to which any of the motor carrier rights are dormant was not disclosed (SP 44; T. 14809-10). No evidence was presented as to the extent of the Rock Island Motor Transit's interline shipments with other common motor carriers (SP 44, p. 3). It should also be pointed out that there is no point of joinder of the operating rights to be acquired by the Southern Pacific Transport and the Rock Island Motor Transit (T. 14798-99). The rights to be acquired by the Southern Pacific Transport south of Kansas City would have to stand on their own as a separate independent motor carrier operation, the feasibility of this, disclosed a deficit operation (SP 44, Ex. C).

Only one short statement, two paragraphs long, was presented by the Union Pacific as to how it intends to operate the Rock Island Motor Transit once it acquired control of the Rock Island Motor Transit's operations north of Kansas City. The Chief Executive Officer of the Union Pacific testified how the Union Pacific planned to operate both the Union Pacific Motor Freight and the Rock Island Motor Transit. The statement certainly does not indicate that the operations as contemplated would be effective, efficient or lead to adequate motor carrier transportation consistent with the public interest. There was some indication that the Union Pacific did not feel it necessary to file a motor carrier application in this proceeding because they were not merging the properties of the Union Pacific Motor Freight and the Rock Island Motor Transit. This seems to overlook the fact that the Union Pacific seeks control of two carriers in this proceeding (UP 2, p. 18). The Union Pacific already controls one motor carrier subsidiary, the Union Pacific Motor Freight whose operations have not been disclosed of record. Certainly the Commission cannot be left to guess what result control by Union Pacific of Rock Island Motor Transit would have in connection with its control of Union Pacific Motor Freight.

The Commission cannot, based upon the evidence presented, find that the disposition of the motor carrier rights and operations of Rock Island Motor Transit are consistent with the public interest. Usually motor carrier applications involving purchase or merger are to extend the benefits of single line service to the shipping public (T. 13132-33). It is a rarity that motor carrier rights would be split in half to create a joint line motor carrier service with interchange of lading and no evidence presented to show this would make an economic or efficient operation. Such a division of motor carrier rights might be appropriate if each of the carriers acquiring the pieces could fit them into their existing motor carrier operations and provide the public with two systems of expanded single line service. This does not appear to be the case here but again we are left to guess what would be the outcome.

It seems to be a substantial contradiction in philosophy for the Union Pacific to advocate, through a railroad merger, the benefits of single line service while proposing in the same proceeding the creation of joint line motor carrier service where single line service existed. It has been found in the public interest to create more single line motor carrier service through mergers (UP 18A, Part III, pp. 29-38; UP 18B, Charts III, T-AA). In the field of railroad mergers it has been found the benefits of railroad single line service are not necessarily significant.[31] This is supported by the Act itself where railroads are required to interchange cars and make joint through rates while motor carriers are not.[32]

As both of these rail carriers, Union Pacific and Southern Pacific, have eliminated the handling of LCL traffic, the shippers at points along their respective railroads are dependent upon motor carriers to provide service for small shipments. The Rock Island Motor Transit Company may well be filling this need for many shippers in small towns along the lines of the Rock Island. There is no evidence in this proceeding that these shippers will be left with an adequate motor carrier service to provide for their needs in the movement of LCL traffic. There is a small shipments problem in the United States and these applicants, Southern Pacific Transport and Union

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[31] *Chicago, B. & Q. R. Co., Control,* 271 I.C.C. 63.

[32] 49 U.S.C. § 3, 49 U.S.C. § 6, 49 U.S.C. § 316(c).

Pacific have not demonstrated a concern for this problem or the public interest in the disposition of these motor carrier authorities.

F. Conditions Proposed By Other Lines To Protect Themselves From A Union Pacific-Southern Pacific Merger Proposal Offer No Public Benefits.

1. Acquisition by Rio Grande of Rock Island Lines West Will Not Prevent Diversion of Traffic from Milwaukee Nor Help it Offset Losses.

The Union Pacific in its frantic efforts to extend from the Missouri River eastward has offered to sell to the Rio Grande certain of the Rock Island lines west of the Missouri River.[33] The Union Pacific made this offer because Rio Grande seeks these lines as a condition of its opposition to the Union Pacific. The Milwaukee neither opposes nor supports Rio Grande's coming to the Missouri River on the lines of the Rock Island in the Union Pacific merger. The Milwaukee asserts, though, that the grant of this condition would not in any manner help the Milwaukee or CM&NW ameliorate the effects of a Union Pacific-Rock Island merger.

The proposal of Rio Grande to acquire the Rock Island lines west of the Missouri River to Denver would not prevent the diversion of traffic from the Milwaukee to the Union Pacific. The traffic to be lost by Milwaukee as a result of the Union Pacific merger is traffic presently moved in connection with Union Pacific and controlled by the Union Pacific. This traffic will be lost and the mere fact that an alternate route to that of the Union Pacific exists at the Missouri River will be of little comfort. Mr. Kronberg, Vice President of the Milwaukee, stated

[33] Joint brief, p. 17.

little traffic would be expected to move via this route in conjunction with the Milwaukee (Milw. 658, p. 18).

The Rio Grande cannot generate or control traffic in sufficient volume to require the Milwaukee to work in connection with Rio Grande. As the Rio Grande is predominantly a bridge carrier on transcontinental traffic, it exerts the least influence on the routing of such traffic (DRGW 489, pp. 1-4, CRL 3.2). The extension of this bridge carrier would have little if any benefit for its connections. On the other hand, Southern Pacific who originates or terminates the vast majority of traffic on the west coast[34] has historically worked in connection with other routes under preferential agreements and could well be expected to work closely with those carriers who originate and terminate traffic in other territories such as the Milwaukee (T. 12558; 12569-70; 12580-81; 12591-93; 12597; 12600). As witness Wyer explained early in these proceedings, retaliation by diverting traffic from connections who also control large volumes of traffic must be undertaken carefully (T. 2742-43). With the tremendous volume Union Pacific originates and terminates, as well as what it handles in connection with Southern Pacific and Western Pacific, there would be no advantage in preferring Rio Grande.

It was also pointed out in the testimony of Mr. Kronberg, that if the Southern Pacific extended its line to Kansas City, the Southern Pacific would expect the Milwaukee to work for the routing of traffic via Kansas City and Southern Pacific (Milw. 658, pp. 17-18). The President of Southern Pacific was well aware that if the Southern Pacific extended its lines to Kansas City the Milwaukee would become a friendly connection at that

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[34] *Southern Pacific Co.—Control Western Pac. R. Co.,* 327 I.C.C. 387.

point (T. 13994-96). If the Milwaukee secures its conditions in the *Northern Lines* case with entry into Portland, and Southern Pacific obtains the Rock Island lines to Kansas City, we as an independent company would expect to work closely with the Southern Pacific at Kansas City and at Portland on north-south Pacific coast traffic. Thus we would be forming a competing route with the Southern Pacific to the Rio Grande's new route to the Missouri River.

It is readily apparent that the extension of the Rio Grande to the Missouri River will not help the Milwaukee offset its losses to a merged Rock Island-Union Pacific nor could it aid the Milwaukee as part of the CM&NW. The merger of Union Pacific-Rock Island with or without the Rio Grande at the River will cause a wholesale realinement of previous traffic routes and patterns.

2. Kansas City Southern Condition only Increases the Social Cost of Excess Capacity and Injures other Railroads.

The KCS has requested affirmative relief in these proceedings in the form of conditions. If the Commission should grant either of the two competing applications, the KCS requests the imposition of similar conditions. One of the conditions which the KCS seeks is for trackage rights over the lines of the Rock Island from Kansas City, Missouri, to Chicago, Illinois, serving one intermediate point, Peoria, Illinois. The Milwaukee is opposed to the granting of this condition under any circumstances.

The KCS did not present any evidence which would justify the imposition of the condition for trackage rights to Chicago. The KCS merely seeks liquidated damages far in excess of any real or imagined injury as a result of the mergers all at the expense of Milwaukee, CM&NW

and others. The condition for trackage rights to Chicago is completely unrelated to any problems created by the merger, purchase or control applications in this case.

The imposition of a condition is similar to a petition for inclusion and the party seeking the condition must bear a burden of proof similar to that of an applicant proving that the conditions are consistent with public interest. *Missouri Pacific-C&EI,* 327 I.C.C. 279, *Chicago & North Western-Great Western,* 333 I.C.C. 236. The KCS's request for trackage rights to Chicago, Illinois, when viewed in the terms of the public interest, would be in derogation of the public interest as it has absolutely no public benefit. This condition does not square with any economic theory which justifies railroad mergers or the conditions attached thereto.

(a) The only reasons advanced for the condition are the self-betterment of the KCS.

The justification offered by the KCS for its condition seeking to reach Chicago, is that Chicago is a large industrial center (KCS 317, p. 14). Further, that the KCS is a small railroad which does not offer extensive single line service and the KCS is at a competitive handicap because it cannot get a line haul on traffic moving from KCS industries at Kansas City to the east (KCS 317, pp. 15-16). The reasons given for imposition of the condition are two-fold, (1) to earn revenue to offset losses, and (2), to expand its efforts to improve service by providing more single line service (KCS 317 p. 32).

The merger applications do not create any of the competitive handicaps referred to by the KCS. To be very candid, the KCS has no real, but only imagined, competitive handicaps. The KCS is an extremely profitable railroad. On a gross 1966 revenue of approximately $79 million, it produced a net income of approximately $11 million (KCS 315 (H)). The President of the KCS conceded that the territory served by the KCS was a good territory and growing (T. 25142). The KCS has one of the lowest operating ratios of any railroad in the country (T. 25141). The good profit and low operating ratio could well be attributed to the fact that the KCS and L&A are made up of all main line railroad except for 71.03 miles of branch line (T. 25155).

We are unable to perceive any reasonable connection between the mergers and the requested trackage rights to Chicago. None of the mergers or control cases affect the KCS or its shippers' ability to reach Chicago and eastern markets in join line service.

(b) The extension of the KCS is not legally possible without Milwaukee consent.

The KCS seeks trackage rights from Kansas City, Missouri to Chicago, Illinois, over the lines of the Rock Island Railroad. The Milwaukee contends that the Commission cannot legally grant such a condition without it or its successor's consent.

The KCS presently operates on its own tracks to a point in Kansas City, Missouri called Airline Junction; at that point the line of the Milwaukee and Rock Island commence and run northward toward Chicago, Illinois (T. 25256). The Rock Island track from Airline Junction, the point of connection with the KCS, north to Polo, Missouri, a distance of 47 miles, is jointly owned and operated by the Milwaukee and Rock Island (Milw. 691, pp. 11-12). The rights of the owning lines are set forth in an agreement dated June 1, 1945, and the agreement prohibits either party from admitting third parties without obtaining the consent of the other owner (Milw. 691,

p. 12). The KCS made no investigation to determine who the owners of the line were, and what their rights were (T. 25258). The KCS requests compulsory negotiations. The Milwaukee, of course, need not negotiate nor can the Commission force upon the Milwaukee or its successor such negotiations under Sections 5(2) of the Act, in a Union Pacific-Rock Island merger. Its powers cannot extend to the taking of real estate from parties such as the Milwaukee, except as an applicant in these proceedings. Neither can the Rock Island, as a controlled carrier, be forced to grant the KCS condition under North Western or CM&NW control.

In *MoPac-C&EI,* 327 I.C.C. 279, the Commission recognized a lack of power in this area. The L&N condition for trackage rights over the C&EI was not granted by the Commission outright. The Commission recognized it could not force the controlled carrier to grant the trackage rights sought but merely required the MoPac to exercise its influence to have the C&EI negotiate with the L&N. This condition requires the consent of both Milwaukee or CM&NW and Rock Island.

(c) The extension of the KCS to Chicago was not proven economically feasible.

The KCS has approached its requested condition for trackage rights to Chicago in a rather cavalier fashion. Estimates of the gains to the KCS were made, but no estimates of the costs to operate the new service were presented. No figures were produced to show the net income effect on the KCS upon reaching Chicago (T. 25142-43). All that the President of the KCS could state was:

> "Q. Are you telling this Commission, Mr. Deramus, that the Kansas City Southern is seeking these

conditions and yet you don't intend to show this Commission what the effect would be if those conditions are granted?"

"A. I think all we are trying to say here is that we want compulsory negotiations; after those negotiations is the time to appear before the Commission and present our case."

"Q. Well, how is the Commission going to determine that those conditions are in the public interest unless you present some evidence, here, sir?"

"A. I think we have given you some income figures. I am not quite sure about expense figures." (T. 25143).

Certainly the Commission cannot grant conditions without more evidence than was here submitted. Some attempt to arrive at the cost of operation should have been presented. The KCS did not attempt to show the cost of the trackage (T. 25143; 25944-45), the cost of equipment (T. 25146) or any operating crew costs. The Commission cannot assume that this could be an efficient economical operation based only on the gross revenue figures.

(d) The cost of handling the traffic diverted to the KCS between Chicago and Kansas City would be greater than the savings other carriers could make by not handling the traffic.

The KCS made studies which showed that if the KCS was granted the trackage rights from Kansas City to Chicago it would handle freight with gross revenues of $6,907,272 (KCS 323, p. 25). This is all traffic diverted from other railroad carriers because the studies were of present rail tonnage handled by the KCS with its connecting carriers and rail traffic now originating at Kansas City handled by the KCS in switch service and moving by carrier east and northeast through the Chicago gateway (KCS 323, pp. 27-28).

As the KCS does not now operate between Chicago and Kansas City, its costs of handling this traffic under its proposed new operation, must be considered full costs. No incremental cost theory related to added traffic could be used to develop the costs. Under the testimony, one train a day would be operated in each direction (KCS 334, pp. 33-35). This requires the total cost of a new train to handle the added traffic. This new operation is the same as a railroad operating at 100 per cent capacity and then adding traffic for another train, handling costs become 100 per cent variable (T. 26051-52). The cost of handling the diverted traffic will be higher than the decremental costs of other carriers losing the traffic between Kansas City and Chicago who cannot take off the equivalent of one daily train, individually or collectively.

The KCS in its study, did not attempt to determine how much traffic each of the present carriers would lose. It was indicated by Dr. Deming, the sampling expert under whose direction the sample was drawn, that it would be impossible to determine the extent of any individual carriers loss (T. 26192). The Milwaukee traffic witness estimated that the Milwaukee would lose in excess of $500,000 of revenue annually (Milw. 660, p. 23).

The Milwaukee presently operates two trains daily between Chicago and Kansas City and for competitive and service reasons could not expect to reduce train service based on this estimated loss (Milw. 691, p. 6). In this respect, the Milwaukee could be considered a "bare bones" carrier (T. 26053).

If the KCS, gaining the traffic, adds new daily train service and the lines losing the traffic are unable to make reductions in train service or reductions to a lesser degree, the total cost of handling the same volume of traffic is higher for all lines (T. 26058). All of the cost theories advanced by the KCS cost witness support this proposition (T. 26054-58). Therefore, the grant of these trackage rights would tend to increase the total cost of transportation of traffic between Kansas City and Chicago and there would be a further social cost to be eventually borne by the public.

(e) Single line service will not result in improved service to the public.

The KCS attempted to justify the extension to Chicago upon the grounds that such service would provide an improved single-line service thus avoiding the terminal congestion of Kansas City. The facts prove conclusively that single line service will not improve service to the shipping public in this situation.

The train schedule proposed for the train operating northbound to Chicago indicates that the train would have to be pre-blocked at Shreveport (T. 25936). Today the train is not pre-blocked at Shreveport and the blocking for proposed train service would consume additional time on a train which presently arrives about 12 hours late on its schedule (T. 44000; 44009; 44020-21).

The testimony of the operating officials about the train is in direct conflict with that of the President of the railroad. The President said that economically feasible operations could be conducted by the KCS on the trains operating between Kansas City and Chicago because they would operate in the same manner as they do today for the operation south of Kansas City (T. 25145-46). It was conceded that the KCS operates heavy long trains and not on a regular schedule (T. 44009-10). The trains are not pre-blocked at any point south of Kansas City. The proposed new train operations will be materially changed from the present method of operations. The proposed train is to be pre-blocked at Shreveport (T. 25936). This will increase the cost of the train operations, for today it operates to Kansas City where the train switching is performed at a Joint Agency with the Milwaukee and costs are split between the two companies (T. 25915-17; 25940). When the prior poor performance of the present train, whose operations are to be extended, was pointed out to the operating witness, he indicated the whole railroad's train operations may change to shorter, faster trains (T. 44018).

The train to Chicago has no planned objective such as connection with eastern carriers (T. 25942-43). Without a planned arrival time at Chicago the delay in interchange service would be substantial. The Chief Operating witness of the KCS had no opinion as to whether a change in the interchange point from Kansas City to Chicago would expedite traffic (T. 25943).

Common sense indicates that one train a day will not provide as good service on *all* traffic handled beyond a junction as the present service of existing interchange carriers at the junction. Our operating witness showed that of necessity a one train a day operation will contain a potential built in maximum delay of 24 hours while two train daily operation has a built in maximum delay of 12 hours (Milw. 691, pp. 9-10; T. 35350-55). For *all* the traffic the service of the KCS and Milwaukee provides a better all around service than would the one train a day operations proposed by the KCS. The Milwaukee and KCS operate out of the same yard under joint operations and interchange between these carriers avoids the Kansas City terminal (T. 25914).

The KCS admitted it was not trying to justify the extension based on shipper needs or inadequacy of service (T. 25220). No need was shown for any new single line service. Shippers are not entitled as a matter of right to single line service when existing joint line service is adequate to serve the public. *Alterman Transport Inc. Extension* 73 MCC 285; *Transamerican Freight Lines, Ext.* 77 MCC 138; *Ringle Truck Lines Inc. Extension* 77 MCC 448; *Oklahoma-Louisiana Motor Freight Co. Ext.* 77 MCC 77; *Chicago B&Q. R. Co.—Control,* 271 ICC 63.

The KCS has utterly failed to show that the request for trackage rights is consistent with the public interest. This condition would frustrate the National Transportation Policy by creating additional duplicate service and facilities having the effect of diverting traffic from other carriers resulting in higher costs for all.

3. The Requests of the Great Northern and Northern Pacific for Trackage Rights and Full Joint Access to the Tukwila and Kent Valley or Publication of a Switching Tariff to Gain Traffic from a Union Pacific-Rock Island System Injures the Milwaukee or CM&NW.

Great Northern and Northern Pacific have requested in similar terms, a condition of a Union Pacific-Rock Island merger, access to the Tukwila and Kent Valley Industrial area.[35] The method of access to the area was placed in the alternative, either by trackage rights or by the publication of switching charges. The Great

[35] Joint brief, p. 53, No. 1; p. 73, No. 4.

Northern and Northern Pacific recognized that the trackage serving the area was jointly owned and that Union Pacific could not grant trackage rights without the consent of the co-owner.

The Tukwila and Kent Valley areas are presently served by the joint trackage of the Milwaukee and Union Pacific. This area is also outside the Seattle switching district which has switching tariffs published providing for connecting line switching. This industrial area sought to be served by Great Northern and Northern Pacific is an exclusive Milwaukee-Union Pacific industrial area not open to reciprocal switching.

These conditions referred to should be denied. The two northern lines are the principal competitors of the Milwaukee through the northern tier of states and if the condition were granted the two northern lines would profit at the expense of the Milwaukee, not the Union Pacific. A grant of these conditions would merely serve to increase the adverse impact of the merger on the Milwaukee (Milw. 657, p. 14).

The Great Northern and Northern Pacific maintain in the Seattle area exclusive industrial areas outside established switching districts which cannot be reached by the Milwaukee. If the Great Northern and Northern Pacific were agreeable to opening up their exclusive industries in the area of the common terminal the Milwaukee would be agreeable to the publication of reasonable switching charges to the Tukwila-Kent area. To prevent injury to the Milwaukee there must be some mutuality in the request of the Northern lines.

G. Union Pacific's Proposed Guarantee Of Its Traffic Diversion Estimates Does Not Make The Merger Any Less Aggressive Or Reduce The Need For Wholesale Diversions From Other Railroads.

On rebuttal, Union Pacific made two efforts to bolster its case. One was its offer to sell or grant trackage rights over Rock Island's western lines to Rio Grande (UP 1085, pp. 14-18). This was done to align Rio Grande on its side as a ploy against the other Midwestern lines and particularly the Milwaukee and North Western affording the Midwestern lines terminating at the Missouri River gateways an alternative non overlapping connection to Union Pacific. However, it also creates for those Midwestern lines terminating at the Colorado gateways a new overlapping and competing connection at the Colorado gateways. We have already discussed the defects of this proposal.

The other last minute proposal was the offer to guarantee North Western or CM&NW (but not the Milwaukee or any other Midwestern line independent of North Western) that it would not divert a greater proportion of its Missouri River interchange with North Western or with CM&NW than was estimated in the 1963 Union Pacific traffic study, provided the North Western or CM&NW would guarantee that CM&NW would not divert more traffic from Union Pacific than North Western estimated in the *Milwaukee* case (UP 1085, pp. 11-12).

After two or three last minute changes, the guarantee formula devised by witness Wyer is the basis of the Union Pacific guarantee (UP 1043, pp. 105-107, Rev.; UP 1050). The guarantee provided, that after an agreed upon historical test period occurring prior to any merger of either Union Pacific-Rock Island or North Western-

Milwaukee, a ratio of the interchange between North Western or CM&NW and Union Pacific at the Missouri River gateways to the total interchange by Union Pacific and by North Western or CM&NW with all of their respective connecting carriers at those gateways would be established. This interchange ratio as to North Western or CM&NW (east of Missouri River) would be reduced by the amount of traffic Union Pacific estimated it would divert from North Western or CM&NW to arrive at an adjusted ratio. As to Union Pacific, (traffic west of the Missouri River) this interchange ratio via Union Pacific would also be reduced by the amount of North Western traffic which North Western estimated in the *Milwaukee* case would be diverted from Union Pacific lines to the Milwaukee's northern route to the Pacific Northwest. The adjusted ratios referred to establishes the critical point on which indemnity is based (T. 44857-58).

The guarantee formula first provided that if North Western's or CM&NW's proportion of total traffic interchanged by Union Pacific with all connections east of the river fell below the adjusted ratios or critical point for any reason, it would reimburse the North Western or CM&NW at 50 percent of the revenue on the additional traffic lost. In the event Union Pacific's proportion of traffic interchanged by North Western or CM&NW with all connections west of these gateways fell below the critical point, North Western or CM&NW would reimburse Union Pacific at 50 percent of the lost revenue accruing to Union Pacific (UP 1043, pp. 105-107, Rev.).

On cross-examination it was pointed out that because the average length of haul of Missouri River interchange traffic was much longer for Union Pacific than for North Western or CM&NW the revenue accruing to Union Pacific was two or three times greater than that accruing to

CM&NW, except on traffic diverted to the Milwaukee's northern transcontinental line. Consequently, for every car of traffic lost by Union Pacific after the critical point, CM&NW would pay 50 percent of two or three times the revenue CM&NW received east of the Missouri River or more in the way of indemnification than the total revenue it earned, except when traffic moved over the CM&NW northern route to the Pacific Northwest. On the other hand, after the critical point for every car CM&NW lost east of the Missouri River, Union Pacific would pay only 50 percent of CM&NW's revenue but Union Pacific would have the revenue west of the Missouri River plus the revenue of an extended haul over the Rock Island with which to pay any indemnification required (T. 44861; 44870; 44873-C; 44873-F; 45031-35; CNW 1049).

When this penalty was acknowledged the formula was again changed to provide that North Western or CM&NW would only reimburse Union Pacific for traffic lost by it west of the Missouri River at 50 percent of the revenue earned by North Western or CM&NW east of the river, except on traffic to the Pacific Northwest (traffic which could move via Union Pacific) line via Huntington, Oregon (T. 45089-94; UP 1050).

One of the problems with the formula is the test period (T. 44893-96). No one can say what effect the Northern Lines merger will have upon the Union Pacific-North Western or CM&NW interchange (T. 44873A-B). No one can say what effect the changes in Condition E of the *Central Pacific* case will have upon this interchange (T. 44876-77). No one can know what effect the sale of the south half of Rock Island would have on this interchange (T. 44877) and no one knows what effect the sale of the Rock Island's western lines would have on this interchange (T. 44877). No one knows what future traffic the growing Pacific Northwest would provide to the CM&NW's northern route by reason of the Northern Lines conditions due to future growth of that territory (T. 44859-61; 44865-66; 48870-73). There simply is no historical traffic pattern which would afford a sound basis for any formula even if it were feasible. Consequently, no one could ever know how the formula would work out. It would be buying a pig in a poke (T. 44880; 44886-87).

But this is not the most condemning feature of the formula. Because each of the two connecting systems who are parties to such a formula would be forced to respect the penalty for diversion of anything more than their estimate regardless of what efforts are put forward by other railroads connecting with one or the other of the parties to the formula. Southern Pacific or Rio Grande's efforts to obtain traffic at either Kansas City or Council Bluffs would be countered by North Western or CM&NW efforts to retain their interchange volume with Union Pacific to the exclusion of Southern Pacific or Rio Grande in order to avoid the indemnity payment (T. 44883-84). Union Pacific would be soliciting for Rock Island lines and could redouble its efforts to obtain more traffic from Missouri Pacific, Santa Fe, Burlington, Illinois Central or Norfolk and Western. CM&NW or North Western would be encouraged to forego routing any new traffic in favor of its northern route to the Pacific Northwest despite the fact that the thin density on that line most needs the added traffic. The entire purpose of the formula is to freeze the present interchange between the Union Pacific and North Western or CM&NW at the critical point to the detriment of every other route (T. 44873-B; 44873-F - 44874; 44877; 44886-95). The entire scheme of the guarantee is to shift the impact of its aggressive scheme of merger to every other railroad in the west and to guarantee that CM&NW's northern route remains an anemic competitor of the Union Pacific in the Pacific Northwest. The Milwaukee cannot agree that the efforts of the Milwaukee and the Commission to provide a competitive route to the Burlington-Northern through the northern tier of states should be so easily stultified by Union Pacific's irrational merger plans (T. 44889-90).

The guarantee is offered for a seven year period after merger. After that, apparently, the Union Pacific's wholesale diversions from the CM&NW group would be on in earnest. The only thing the Union Pacific's guarantee does is to point up the fact that Union Pacific has grossly understated its traffic gains from the Midwestern railroads. Otherwise, the guarantee formula would be unnecessary. Nothing about this formula cures the Union Pacific's need for obtaining increased revenues from other railroads if it is to carry out its merger and improvement program for Rock Island lines.

CONCLUSION

The opposing applications in this proceeding have only one thing in common and that is they both have their defensive aspects. Union Pacific seeks the Rock Island to prevent changes in traffic patterns due to a CM&NW merger and control or eventual merger of Rock Island into that system. CM&NW seeks control of Rock Island to prevent changes in its traffic patterns by reason of a Union Pacific-Rock Island merger. But that is all they have in common.

Union Pacific's proposal in addition to being defensive is ruthlessly aggressive. It also wants to protect its earnings from the effect of the *Divisions* case and revisions to its preferential routing arrangement with

Southern Pacific and more recently the *Per Diem* case. CM&NW has no such purpose in seeking Rock Island. The extent these two proposals are aggressive or not aggressive is reflected in the traffic diversion estimates and positions of parties opposing these two mutually exclusive applications as set forth in the joint brief.

Union Pacific, in its effort to avoid the cannibalistically aggressive aspects of its proposal so far as CM&NW is concerned has offered to guarantee its estimate of diversion if CM&NW will do the same. Even if anyone could fathom how this guarantee would work out in practice between these opposing applicants, it would in effect become even more aggressive toward other opposing railroads.

Union Pacific is even willing to forego, for a price, its aggressive desire to overcome the revisions to Condition E by selling Rock Island lines to Rio Grande, but with its guarantee this is a hollow promise for Rio Grande. In any case, its merger proposal becomes more aggressive with respect to railroads serving the Colorado gateways with no service improvements.

The major point of departure of the two opposing applications is that Union Pacific's proposal promises no service improvements or efficiency but promises economic and financial waste whereas the CM&NW proposal promises more efficient operations at less cost through elimination of unneeded duplicate lines and terminals and improved service by reducing congestion at terminals, and with the concentration of more traffic on fewer lines, more frequent schedules and faster service between origin and destination.

CM&NW's proposal promises important improvements in net income for the combined CM&NW and Rock Island through reductions of excess capacity with minimal injury to other underutilized railroads. Union Pacific's proposal threatens to either reduce the combined income of Union Pacific-Rock Island under what Union Pacific or what Union Pacific and Rock Island in the aggregate presently enjoy, or in the alternative, reduce the net income of every other opposing railroad with no offsetting efficiencies or service improvements.

CM&NW's proposal would not only benefit CM&NW and Rock Island, but the entire railroad industry by providing a more efficient use of land, labor and capital as well as better service.

Union Pacific's proposal would not benefit the railroad industry in any of these respects, but is parasitic.

The examiners and the Commission should find from the foregoing that Union Pacific's proposed merger with Rock Island is not consistent with the public interest and that North Western's or CM&NW's control of Rock Island as a preliminary to merger is consistent with the public interest.

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Due Date: January 27, 1969.

CERTIFICATE OF SERVICE

I, ROBERT F. MUNSELL, hereby certify that I have this day served a copy of the foregoing Brief of Intervenor upon all parties of record in this proceeding by mailing a copy thereof, by first-class mail, properly addressed, to each such party.

Dated at Chicago, Illinois this 24th day of January, 1969.

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Robert F. Munsell

I.C.C., F.D. No. 22688 et al.
Appendix No. CEC-7
Witness: C. E. Crippen