BEFORE THE
SURFACE TRANSPORTATION BOARD

ENTERGY ARKANSAS, INC. and ENTERGY SERVICES, INC., Complainants v. UNION PACIFIC RAILROAD COMPANY and MISSOURI & NORTHERN ARKANSAS RAILROAD COMPANY, INC., Defendants.	)	Docket No. 42104 223498
MISSOURI & NORTHERN ARKANSAS R.R. – LEASE, ACQUISITION AND OPERATION EXEMPTION – MISSOURI PACIFIC R.R. and BURLINGTON N. R.R.	)	Finance Docket No. 32187 223497

REBUTTAL EVIDENCE AND ARGUMENT

REDACTED, PUBLIC VERSION
– MATERIAL UNDER SEAL DELETED –

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REBUTTAL EVIDENCE AND ARGUMENT

Entergy Arkansas, Inc. ("EAI") and Entergy Services, Inc. ("ESI") (collectively, "Entergy") hereby submit this Rebuttal Evidence and Argument in accordance with the revised procedural schedule in effect in this case. *See Entergy Arkansas, Inc. and Entergy Services, Inc. v. Union Pacific R.R. and Missouri & Northern Arkansas R.R.*, STB Docket No. 42104, *et al.* (STB served May, 19, 2008) at 6.

INTRODUCTION AND SUMMARY

Entergy filed its Opening Evidence and Argument in this proceeding on July 11, 2008. Therein, Entergy demonstrated that the continued enforcement of the interchange restrictions set forth in the 1992 Lease between Union Pacific Railroad Company ("UP") and the Missouri & Northern Arkansas Railroad Company, Inc. ("M&NA") constituted an unreasonable practice. Entergy further showed, in the alternative, that the Board should revoke, in part, the exemption through which authorization for the transaction was obtained, or should find that the Lease constituted a pooling arrangement implemented without specific agency approval. Entergy's filing included the verified statements of Mr. William Mohl, Mr. Daniel Gray, and Mr. Thomas D. Crowley, and the joint verified statement of Dr. John E. Kwoka, jr. and Dr. Frederick R. Warren-Boulton.

The verified statements submitted by these witnesses documented: (i) UP's refusals to permit the diversion of Entergy's traffic to an alternative carrier during times of inadequate UP service; (ii) the excessive level of the interchange-restricting rent schedule set forth in the UP/M&NA Lease; and (iii) the relationship of the financial impact of the Lease and its interchange restrictions to UP's pre-transaction going concern value. Notably, this evidence regarding the financial impact of the Lease, which Mr. Crowley submitted, specifically corresponded to the analysis outlined in the Board's October 30, 2007 decision in *Review of Rail Access and Competition Issues – Renewed*

Petition of the Western Coal Traffic League, STB Ex Parte No. 575 (STB served Oct. 30, 2007) ("Ex Parte No. 575"). Finally, Entergy's July 11 filing also included testimony demonstrating that the relief that Entergy seeks is consistent with accepted economic theory and policy.

UP and M&NA each filed reply evidence on August 11, 2008. Each argues that the Board should refrain from granting relief to Entergy.

In its Rebuttal Evidence and Argument, Entergy responds to the various arguments raised by the Defendants in their Reply filings, and provides further support for the relief that it seeks in this case. In addition to this Argument of Counsel, Entergy's Rebuttal Evidence and Argument includes the following witness statements:

(1) the Rebuttal Verified Statement of Mr. William M. Mohl, Vice President – System Planning & Operations for Entergy Services, Inc.;

(2) the Rebuttal Verified Statement of Mr. Daniel B. Gray, Senior Transportation Analyst for Entergy Services, Inc.;

(3) the Rebuttal Verified Statement of Mr. Thomas D. Crowley, President of L.E. Peabody & Associates, Inc.; and

(4) the Joint Rebuttal Verified Statement of Dr. John E. Kwoka, jr. and Dr. Frederick R. Warren-Boulton of Microeconomic Consulting & Research Associates, Inc. ("MiCRA").

ARGUMENT

I. UP's Reply Evidence is Premised Upon the Incorrect View that it is Impossible for Shippers to Obtain Relief from Pre-Existing Paper Barriers

It is evident from a review of UP's Reply Evidence that UP's principal quarrel in this proceeding is not with Entergy, but instead, with the Board's October 2007 Decision in Ex Parte No. 575. In that Decision, the Board confirms that – notwithstanding the benefits that have been associated with the creation of short-line railroads (and the role that interchange commitments may have played in that process) – it nevertheless is possible for the continued enforcement of a pre-existing interchange commitment to be unreasonable and contrary to the public interest. *See*, *e.g.*, Ex Parte No. 575 Decision at 13 ("The foregoing [discussion of the benefits of interchange commitments] should not be understood as a suggestion that all current and future interchange commitments are necessarily reasonable and in the public interest . . . .") (emphasis added); *id.* at 15 ("Even though we are not prohibiting the use of existing interchange commitments across the board, shippers may, on a case-by-base basis, attempt to show that a particular interchange commitment is causing, or would cause, a violation of the Interstate Commerce Act or that it is, or would be, contrary to a particular statutory provision under which approval was, or is being, sought.").[1] As described

[1] *See also id.* at 7-8 ("A particular interchange commitment may be contrary to the public interest because it is unduly restrictive or unwarranted under the circumstances.").

below, UP's Reply Evidence assumes that relief from pre-existing paper barriers simply is not possible.

A. UP Repeatedly Assumes that the Absence of Pre-Transaction Competition Immunizes the Terms of its Lease from Scrutiny in this Case

In its Reply Evidence, UP repeatedly emphasizes that Entergy should not be entitled to obtain any relief in this proceeding because Entergy did not enjoy any pre-lease competition for delivery service to Independence. *See*, *e g.*, UP Reply at 1-2, 14-16, 24, 38-39, and 51. The absence of pre-lease competition does not definitively resolve this case in UP's favor. In fact, if that absence of pre-lease competition were sufficient, in and of itself, to warrant the rejection of Entergy's Complaint, then there would have been no purpose served by the Board's decision to adopt a case-by-case approach to analyzing pre-existing interchange commitments. *See* Ex Parte No. 575 at 1, 7-8.

To the contrary. if the answer to the simple question that UP has framed regarding pre-lease competition were adequate to resolve this case, it would have been entirely straightforward for the Board to impose a rule of general applicability in Ex Parte No. 575 stating that shippers lacking pre-transaction competitive options would be prohibited from obtaining relief from paper barriers. Obviously, the Board did not impose such a rule, and UP therefore should not be heard to argue in a manner that assumes that the imposition of that rule had been the Board's intended result. *Cf.* Ex Parte No. 575 at 19 (Commissioner Mulvey, commenting) ("Our proposed rules should enable shippers who believe they are aggrieved by interchange commitments to challenge these restrictions in a more direct and expeditious manner. I expect the Board to administer these rules in such a way that they offer meaningful, as opposed to elusive, relief."). UP's Reply Evidence invites the Board to strip all meaning from the Ex Parte No. 575 decision with regard to pre-existing paper barriers and to render relief under that decision completely elusive.

UP's flawed premise that the absence of pre-lease competition makes relief from pre-existing paper barriers impossible also is evident from UP's discussion of the rent level in the UP/M&NA Lease. Specifically, UP responds to Entergy's criticisms of the excessive level of the rental payments set forth in the Lease by insisting that the continued enforcement of that provision would be proper no matter what rent level had been set. *See, e.g.*, UP Reply at 31 (dismissing as "irrelevant" concerns regarding the level of the rent payment "no matter how high UP and M&NA agreed to set the rent . . ."); Rubinfeld V.S. at 21 (rent payment "cannot be deemed anticompetitive – regardless of its level"). Essentially, UP's position regarding the supposedly unquestionable propriety of *__any__* rent level whatsoever is that an interchange restriction – even with a very high rent level – cannot reduce competitive options for a shipper that lacked competitive options before the lease. *Id* at 35 ("A high rent payment could not harm competition; it could do no worse than maintain the pre-transaction competitive *status quo*."). The Board's Ex Parte No. 575 standard, however, contemplates an evaluation of the reasonableness of the terms of interchange commitments and confirms that reasonable interchange restrictions must be limited to the protection of the pre-transaction going concern value of a line.

UP's suggestion that the rental level in its agreement with M&NA is entirely beyond question clearly goes too far. Again, if UP's argument were correct, then there would have been no basis for the Board to afford consideration to the reasonableness of pre-existing paper barriers on a case-by-case basis.

Based upon its underlying premise that relief from pre-existing paper barriers is entirely unavailable, UP articulates a standard for evaluation of its paper barrier that would immunize Class I monopolists from scrutiny for any actions that they take to restrict competition in spin-off transactions. *See* UP Reply at 18. In particular, UP argues that "leases containing interchange commitments are not unlawful or contrary to the public interest as long as they do not give the lessor greater market power or control over rates or routes than if it had never leased its lines." *Id.*; *see also id.* at 24 ("The UP/M&NA Lease's interchange commitment is lawful and consistent with the public interest because it did not reduce or eliminate any competitive rate or routing options available to Entergy or any other shipper on the lines UP leased to M&NA."). If a Class I carrier lacked any competition for service prior to a spin-off transaction, then a spin-off transaction, under UP's proposed standard, could never give the lessor greater market power.

Obviously, the Board did not intend UP's simplistic analysis to be sufficient to resolve the entire question of paper barriers. The Board intended a more searching inquiry into the reasonableness of a particular paper barrier and Entergy's evidence in this proceeding addresses that inquiry. There is no reason to suspect that the Board is precluded for adopting an approach in this case that would do more that simply check whether a complaining shipper had multiple service options before a given spin-off transaction. *See*, *e.g.*, Ex Parte No. 575 at 18 (Commissioner Mulvey, commenting) ("[W]e have the discretion to adopt policies that *promote* competition. *See, e.g.*, *Major Rail Consolidation Procedures*, 5 S.T.B. 539 (2001).") (emphasis in original).

In that regard, it is important to re-emphasize that the present inquiry is not a competitive access case in which a shipper seeks to obtain two-carrier service at a destination that has been served on an ongoing basis by a Class I carrier. To the contrary, UP made an affirmative decision in 1992 to lease its line to M&NA. The question in this case therefore is not whether Entergy has met a competitive access standard to force UP to open the Independence destination to competitive service, but instead, whether it is reasonable to continue to allow the interchange restrictions associated with the Lease to remain in effect under the present circumstances (*i.e.*, after UP's recovery of the Line's pre-transaction going concern value) since it is the need to protect pre-transaction GCV that constitutes the justification for paper barrier restrictions.

In addition to misstating the proper legal standard in this case, UP also mischaracterizes the nature of Entergy's Complaint. In particular, UP claims that Entergy's argument with the UP/M&NA Lease is that it did not *expand* Entergy's competitive options. *See* UP Reply at 1-2, 18. That is incorrect. Entergy's fundamental argument in this case is that under the Board's Ex Parte No. 575 standard, it would be unreasonable to continue enforcement of the restriction on interchange after UP has recovered the going concern value for the line. *See* Ex Parte No. 575 at 10-11 ("The revenue stream resulting from the agreement should be no more than what the carrier would have received had it not divested or leased the rail facilities in question, or had it demanded more in the sale price or rental fee.[] So long as that is the case, the interchange limiting provision would not overcompensate the carrier . . . .").

Significantly, the policy justification for tolerating paper barriers is that such restrictions can help to facilitate the rationalization of the railroad system. *See* Ex Parte No. 575 at 4-5. Through the use of paper barriers in spin-off transactions, short lines are able to avoid the problem of paying the full going concern value of the line, and Class I carriers are able to protect pre-transaction going concern values. *Id.* at 10-11. Above and beyond the point at which an interchange commitment protects the pre-transaction going concern value of the line, however, the fundamental justification for the use of the paper barrier disappears. *Id.* Entergy demonstrated in its Opening Evidence that this threshold has been exceeded under the UP/M&NA Lease.

Eventually, UP grudgingly acknowledges in its Reply that the Board's Ex Parte No. 575 decision provided instructions for shippers seeking to challenge pre-existing interchange commitments. *See* UP Reply at 19. This acknowledgement directly contradicts the underlying premise of the balance of UP's Reply that the Board did not intend to allow any challenge to pre-existing paper barriers.

B. UP's Reliance on ICC Precedent is Misplaced

In its Reply Evidence, UP relies on two ICC decisions in support of its claim that relief from pre-existing paper barriers effectively is never appropriate. *See* UP Reply at 11-12 (citing *Class Exemption for the Acquisition and Operation of Rail Lines Under 49 U.S.C. § 10901*, 1 I.C.C.2d 810 (1985) and *Montana Rail Link, Inc. – Exemption Acquisition and Operation – Certain Lines of Burlington N R R.*, ICC Finance Docket No. 31089 (ICC served May 26, 1988)); *see also* UP Reply at 25 ("As the ICC made clear in *Class Exemption* and *Montana Rail Link*, short line spin-offs are consistent with the public interest as long as they maintain the competitive status quo – there is no requirement that they create new competition.") (citing *Class Exemption*, 1 I.C.C.2d at 817; *Montana Rail Link* at 20).

While it is certainly correct that the agency endorsed the use of exemptions to obtain authorization for spin-off transactions in *Class Exemption* and the agency permitted interchange restrictions in *Montana Rail Link*, Entergy submits that UP has improperly sought to minimize the impact of the Board's Ex Parte No. 575 decision on this ICC precedent. In particular, UP contends that the Board's Ex Parte No. 575 decision only modified the standard reflected in these two decisions for cases involving proposed paper barriers, not pre-existing paper barriers. UP Reply at 21 ("The Board's only change in its approach to interchange commitments was to expose *proposed* interchange commitments to scrutiny before transactions were exempted, rather than rely on the revocation procedure discussed in Class Exemption.") (emphasis in original); *see also id.* ("With respect to existing interchange commitments, the Board merely reaffirmed what the ICC had recognized in *Class Exemption* . . . .").

Stated differently, UP argues that the Board's Ex Parte No. 575 decision had absolutely no meaning whatsoever for paper barrier restrictions that were already in place and had been the subject of several years' worth of discussion in the Ex Parte No. 575 proceeding. Entergy respectfully submits that the language of the Ex Parte No. 575 decision does not support UP's narrow reading. *See, e.g.*, Ex Parte No. 575 at 10-11 (addressing the subject of pre-transaction going concern value and the possibility that a paper barrier arrangement could overcompensate the Class I carrier); *id* at 13, 15.

Interestingly, the ICC's early decisions regarding the use of exemptions for short-line spin-offs were not free from dispute. In fact, contrary to UP's claim in its Reply Evidence (*see* UP Reply at 13 & Wilson V.S. at 2 n.1), there was significant opposition at the time to the use of paper barriers, and stated opposition from members of the agency to the use of this type of mechanism. For example, Commissioner Simmons expressed serious concerns with the use of interchange restrictions in his dissenting statement in *Montana Rail Link*. *See Montana Rail Link, Inc. – Exemption Acquisition and Operation – Certain Lines of Burlington N R.R.*, ICC Finance Docket No. 31089, 1988 WL 224308 (ICC served May 26, 1988). In particular, Commissioner Simmons suggested that the case represented a "disturbing trend" and he remarked that the Commission's approach failed to maintain the agency's historic practice of working to "increase the level of competition" and to protect captive shippers:

> I cannot subscribe to the majority decision which, in my view, endorses a disturbing trend in rail spinoffs. This trend is the increasing prevalence of provision in sales agreements which seriously hamper the new carrier's ability to compete. The numerous limitations impose on Montana Rail Link's ability to offer responsive and competitive service should receive the most careful scrutiny by this Commission. This simply has not been done in today's decision.
>
> <u>Especially since passage of the Staggers Act, the ICC has worked to increase the level of competition among rail carriers while maintaining necessary protections for captive shippers</u>. The analysis of competitive issues in the majority's decision is inconsistent with that goal.

Id. at * 28 (emphasis added).

In addition, Commission Lamboley took the extraordinary step in the *Montana Rail Link* case of filing a lengthy, separate dissent nearly two months after the date of the Commission decision on which UP relies. *See Montana Rail Link, Inc. – Exemption Acquisition and Operation – Certain Lines of Burlington N. R.R.*, ICC Finance Docket No. 31089, 1988 WL 22451 (ICC decided July 19, 1988). Therein, Commissioner Lamboley sharply challenged the interchange restrictions in the BN agreement, which imposed "supplemental charges on potential MRL interlines with other rail carriers." *Id.* at *4. According to Commission Lamboley, "evidence of a restrictive tie-in arrangement between BN and MRL and the substantial financial and operational dependence of MRL on BN, combined with the closure of three gateways, substantiate the existence of significant anti-competitive consequences and concerns involved in this transaction." *Id.* at *3.

Commissioner Lamboley also explained that the Commission had failed to ensure that the anti-competitive restrictions imposed by BN would not violate the public interest. Specifically, Commission Lamboley observed that "merely stating that competition is not reduced by the transaction is not sufficient. . . . We need to satisfy public interest concerns that any anti-competitive restrictions do not preclude the new entity from reasonably competing for new as well as existing business, nor, accordingly, from reasonable opportunities to succeed." *Id.*

On the basis of these factors, Commissioner Lamboley characterized *Montana Rail Link* as a "low-cost BN subsidiary." *Id.* at *4 ("From the existing record, one can more reasonably conclude that MRL will, for all intent, effectively become a low-cost BN subsidiary, rather than a new regional line with independent, competitive vitality. Thus, a private, rather than a public benefit would be the apparent result."). He also observed that "[a]bsent sufficient transportation justification of record, one is moved to conclude that this transaction is a vehicle solely to provide a unilateral remedy to BN's labor concerns . . . ." *Id.*

Each of these observations is relevant to the instant case. Here, UP contends that merely showing that competition was not reduced should be sufficient to immunize the paper barrier restrictions from scrutiny. {[redacted]}. And here, it is evident that the result of this labor-driven transaction was to transform M&NA into the equivalent of a low-cost UP subsidiary without the burden of compliance with the labor agreements that would apply to actual UP service.

In a related matter, Entergy explained in its Opening Evidence that Section 15.01 of the Lease (which allows UP to terminate the Lease in the event the rent provision is found to be improper) reflects UP's brinksmanship in drafting and its awareness that its paper barrier could be found to be unlawful. *See* Entergy Opening at 9. On Reply, UP attempts to dismiss this explanation, suggesting that it had relied on "clear" agency precedent in preparing the Lease and had included Section 15.01 simply to "provide 'just in case' protection for an agreement that could potentially be in effect for 80 years." Wilson V.S. at 2 n.1; UP Reply at 55 n.34. Entergy respectfully submits that the inclusion of Section 15.01 in the Lease is more persuasive evidence of UP's 1992 concern regarding the potential rejection of its paper barriers than UP's 2008 claim that it had no such concerns.[2]

One final point regarding UP's reliance on *Montana Rail Link* merits a response. Specifically, UP quotes the *Montana Rail Link* decision for the proposition that a lease accompanied by an interchange commitment will not be considered to be anticompetitive as long as there is "no new condition imposed upon the traffic by [the] transaction that would cause a shipper to pay rates exceeding the levels it would have otherwise faced with the prior, single carrier." UP Reply at 25 (quoting *Montana Rail Link* at 20). Significantly, the UP/M&NA Lease has the potential to require Entergy to pay rates exceeding the levels it would have faced in the absence of the transaction. As Entergy explained in its request for clarification regarding a potential bottleneck maximum rate case, the existence of the paper barrier in the UP/M&NA Lease could, absent clarification from the Board, cause Entergy "to pay rates exceeding the levels it would have otherwise faced with the prior, single carrier." *See* Entergy Opening at 65-

[2] UP's Reply Evidence also includes the suggestion that {[redacted]}. UP Reply at 8 (citing Wilson V.S. at 9 & UP Counsel's Exhibit No. 5). The documentary evidence on which UP relies to support this assertion indicates that UP may have erred in its recollection of the timing of the events surrounding the lease. UP Counsel's Exhibit No. 5 is a letter agreement between UP and Entergy that is dated May 27, 1993 (and was signed by Entergy on June 7, 1993). The UP/M&NA Lease is dated December 11, 1992. There is no indication in the documentary evidence that {[redacted]} – or even that Entergy had any awareness of the Lease – prior to its execution.

67. Consequently, the continued enforcement of the UP/M&NA paper barrier restrictions would be anticompetitive and inappropriate even under the standard advocated by UP.

C. The Defendants' Discussion of the Board's Ex Parte No. 575 Standard Includes a Number of Additional Errors

UP and M&NA's discussion of the legal standard developed by the Board in its Ex Parte No. 575 decision includes several additional errors: (1) UP claims that Entergy's evidence is "unremarkable" and "borders on the absurd" without recognizing that Entergy simply has complied with the Board's evidentiary guidelines; (2) UP claims that strict scrutiny under Ex Parte No. 575 for "perpetual" paper barrier restrictions applies only to new paper barriers; and (3) UP and M&NA claim, in any event, that perpetual restrictions are only those that last forever.

1. UP is Wrong to Attempt to Dismiss Entergy's Evidence as "Unremarkable"

In its Opening Evidence, Entergy demonstrated that the pre-transaction net present value of the revenue contribution resulting from the Lease/Sale Transaction exceeded what UP would have received had it not entered into the transaction. *See* Crowley V.S. at 7. Entergy's Witness Crowley performed his examination of this issue using three different analyses, and in each analysis, the net present value of the revenue contribution resulting from the Lease/Sale Transaction exceeded that which UP would have received had it not entered into the agreements with M&NA. *Id.* Specifically, Mr. Crowley examined the impact of the transaction on the pre-transaction going concern value of the line: (1) using UP's own October 1992 analysis (which excluded Entergy's traffic); (2) using UP's October 1992 analysis supplemented to include Entergy's traffic; and (3) using the pre-transaction net present value of the cash flows associated with the actual historic traffic that moved under the transaction through 2007. *Id.* at 8.

UP characterizes Entergy's evidence regarding the greater contribution associated with the transaction as "unremarkable," and suggests that Entergy's analysis "borders on the absurd." *See* Baranowski V.S. at 1-2 & 4; UP Reply at 27. Significantly, however, the evidentiary demonstration that Mr. Crowley made in his Verified Statement directly corresponds to the Board's explanation in Ex Parte No. 575 of the manner of determining whether a proposed interchange commitment is reasonable, or instead, if that commitment would overcompensate the carrier. *See* Ex Parte No. 575 at 10-11. UP may regard that analysis as "unremarkable" or "absurd," but that is the analysis that the Board identified in its Ex Parte No. 575 decision. Mr. Baranowski's rebuttal on this point offers no expert opinions or theory that supports the rejection of Entergy's application of the Board's standards.

2. UP Improperly Attempts to Limit the Board's Strict Scrutiny Standard

In Ex Parte No. 575, the Board explained that "[p]arties should expect a higher level of scrutiny [from the Board] on agreements that contain a total ban on interchange with other carriers or go on in perpetuity." Ex Parte No. 575 at 15. Entergy explained in its Opening Evidence that the paper barrier restrictions in the UP/M&NA

Lease continue in effect for the entire term of the Lease (up to 80 years) and therefore are subject to the "higher level of scrutiny" that the Board identified in Ex Parte No. 575. *See* Entergy Opening at 9; *see also id.* at 18 ("[T]he higher level of scrutiny that the Board describes applies in the instant case because the paper barrier in the UP/M&NA lease goes on in perpetuity in the sense that it extends for the full term of the lease, which may be eighty years.").

In its Reply Evidence, UP takes issue with Entergy's suggestion, arguing that the Board intended to limit its "higher level of scrutiny" to proposed interchange commitments, rather than pre-existing commitments. UP Reply at 20 n.11. While it is correct that the Board refers to the higher level of scrutiny for perpetual restrictions in a paragraph that begins with a discussion of proposed commitments, Entergy respectfully submits that UP is wrong to assume that the Board intended to limit its higher level of scrutiny to proposed "perpetual" restrictions, but to ignore the distinction between "perpetual" and temporary restrictions for existing paper barriers. This argument from UP thus represents another manifestation of the view that all existing paper barriers are entirely immune from scrutiny.

3. The Defendants' Adopt Illogical <u>Interpretations of the Term "Perpetual"</u>

UP and M&NA each also adopt entirely illogical interpretations of the term "perpetual" in an effort to exonerate the UP/M&NA Lease from the Board's higher level of scrutiny. In particular, each carrier argues on Reply that the interchange restriction in the UP/M&NA Lease is not "perpetual" because it lasts only as long as the Lease itself.

UP's description of its view of "perpetuity" advances a functional interpretation of the term, suggesting that a restriction should not be understood to go on in perpetuity if it only lasts as long as necessary. *See* UP Reply at 20 n.11 ("[T]he challenged interchange commitment does not go on 'in perpetuity,' or <u>any longer than necessary to serve its purpose</u>; it expires when the lease expires.") (emphasis added). Under this functional interpretation, UP claims exemption from heightened scrutiny where an interchange restriction "only" extends for the full duration of the Lease. This interpretation is, of course, entirely illogical. If the Board intended to distinguish between perpetual and temporary restrictions in the manner advocated by UP, then the only "perpetual" restrictions that the Board would identify would be those that extend *beyond* the termination date of a given lease. Entergy anticipates that the Board would never encounter a lease provision that lasts longer than the lease itself, and therefore that the entire universe of lease interchange restrictions, regardless of the length of the lease term, under the definition advocated by UP would be zero. Entergy submits that the Board should reject UP's interpretation because that interpretation illogically assumes that a lease restriction is perpetual only where it is "longer than necessary" to serve its purpose of completely precluding the diversion of traffic for the life of a lease. There is no logical reason why a carrier would impose a restriction on interchange in a lease that exceeded the duration of its lease.

M&NA's interpretation of the term "perpetual" is no more logical than UP's, but it is premised upon a different theory and is accompanied by a lengthier discussion. According to M&NA, the Board intended to impose higher scrutiny only upon paper barrier restrictions that literally last "forever," and M&NA further argues that such scrutiny is inappropriate where, as here, M&NA anticipates that UP will waive the rental payment in the future:

> Entergy argues that the Interchange Commitment continues in perpetuity because it extends "for the full term of the lease, which may be 80 years." (CA at 18). Black's Law Dictionary defines perpetuity as "the state of continuing forever." Neither the Lease nor the Interchange Commitment continues forever. The Lease can be terminated by UP or M&NA if the rental provision is changed. . . . Pursuant to Section 23.08 of the Lease, the Interchange Commitment has been waived in the past . . . and M&NA is confident that the Interchange Commitment can and will be waived in the future.

M&NA Reply at 10-11 (emphasis added). M&NA further argues that "following Entergy's logic would lead to the conclusion that every Interchange Commitment in every Lease is in perpetuity unless it terminates prior to the end of the lease." *Id.* at 11. In effect, M&NA suggests that the Board should apply the same level of scrutiny whether a lease and its interchange restriction would be in effect for five (5) years or seventy-five (75) years. This suggestion is illogical. The Board's higher scrutiny standard should be interpreted in a manner that gives it practical relevance consistent with sound public policy. Entergy respectfully submits that an interchange restriction that will remain in effect for the entirety of a Lease that has a term that could extend for 80 years should be regarded as "perpetual" and should be subject to a higher level of Board scrutiny.

Notably, the Defendants' efforts to distinguish the UP/M&NA Lease restrictions from the "perpetual" description in the Board's decision also are inconsistent with UP's claim that the extremely long durations of the Lease and its interchange restrictions justify the parties' decision to establish a rent provision tied to revenues (rather than contribution). *See, e.g* , UP Reply at 31, at 34; V.S. Wilson at 14; V.S. Baranowski at 7. Obviously, a tension exists between these two arguments made by the Defendants.

II. UP's Reply Evidence Regarding UP's Service Failures is Incorrect

Entergy's Opening Evidence presented an explanation of the extended periods during the past fifteen years in which UP's service quality has been inadequate. *See* Mohl V.S. at 5-6; Gray V.S. at 5-11. While UP downplays these failures as "three events," the reality is that UP's service has been seriously compromised in nine of the last fifteen years. Gray V.S. at 5-11. During these periods of service disruption, as Entergy explained, UP repeatedly has refused to allow M&NA to provide service to Entergy in conjunction with a competing long-haul carrier, notwithstanding UP's own inability to provide adequate service. *Id.* Finally, Entergy documented UP's trend in recent years to utilize force majeure declarations as a means of attempting to exonerate itself from responsibility for providing service in accordance with the parties' contract. *See* Mohl V.S. at 7-8. Through the aggressive use of this practice, UP has claimed to be excused from its contractual delivery obligations for 42% of the time during the period from April 2005 through April 2006. *See* Mohl Rebuttal V.S. at 4.

On Reply, UP endeavors to excuse its various service failings and its refusal to allow Entergy to obtain relief from such problems through BNSF-M&NA service. *See* UP Reply at 38-46; Gough V.S. at 3-11. UP also UP insists that Entergy has overstated the number of force majeure days claimed by UP in recent years, and argues that it "continued to deliver as much coal as it reasonably could, even when it declared force majeures." Gough V.S. at 10 & n.4; *see also* UP Reply at 45 n.29 ("Entergy has significantly exaggerated both the number and the effect of UP's force majeure declarations.").[3]

As Entergy witnesses William Mohl and Daniel Gray explain in their Rebuttal Verified Statements, UP's Reply Evidence is misleading and incorrect in

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[3] In his Reply Statement, UP's Mr. Gough notes that "Entergy's rates have fallen since the lease." Gough V.S. at 2. Mr. Gough neglects to mention, however, that {[redacted]}. *See* Mohl Rebuttal V.S. at 7 n.1. Moreover, as Mr. Mohl explains in his Rebuttal Verified Statement, UP has less of an incentive to use its resources to serve lower-contribution, legacy contract customers during times of constraint. *Id.* at 6.

substantial respects. In particular, Mr. Mohl points out that in responding to Entergy's evidence regarding reliability concerns, Mr. Gough is "very careful never to discuss UP's obligations under the existing Coal Transportation Agreement between UP and Entergy," but instead, he "speaks very generally about UP's 'reasonable efforts,' and UP's overall 'incentives' to deliver as much coal as possible." Mohl Rebuttal V.S. at 1.

Mr. Mohl also makes a modest correction to his Opening Statement regarding the number of days on which UP had declared force majeure between April 2005 and April 2008. Specifically, Mr. Mohl explains that the correct number of days on which UP had declared force majeure was *only* 461.7, rather than the 487.1 figure he identified on Opening. *See* Mohl Rebuttal V.S. at 3-4. This equates to 42% of the number of days in the subject time period, rather than 45% as Mr. Mohl previously suggested. *Id.* at 4. As such, UP's claim that Entergy "significantly" overstated the number of UP force majeure days declared by UP in recent years is incorrect. It is very apparent that UP has relied heavily upon force majeure declarations to attempt to exonerate itself from responsibility for poor service. In this regard, Mr. Mohl further explains in his Rebuttal Statement that, notwithstanding UP's claims regarding the use of reasonable efforts during periods of force majeure, "it is essential for Entergy to pursue all reasonable options for supplemental deliveries" during a force majeure period. *Id.* at 3. The presence of the UP/M&NA paper barrier presents a serious impediment to those efforts. *Id.* at 4.

In his Rebuttal Verified Statement, Mr. Gray responds to UP's arguments regarding UP's refusals to allow Entergy to obtain alternative service during the three principal periods of UP service failures (*i e*, 1993-1995, 1997-1998, and 2005-2006). *See* Gray Rebuttal V.S. at 1-8. With respect to each period, Mr. Gray explains that UP has failed to refute Entergy's explanation that UP declined to waive the restrictions on M&NA's interchange with another long-haul carrier. *Id.*

III. UP Fails to Offer Any Meaningful Challenge to Entergy's Quantitative Showing Under the 575 Standard

In accordance with the Board's guidance in Ex Parte No. 575 (*id.* at 10-11), Entergy submitted evidence to the Board in the Opening round of evidence documenting the anticipated impact of the Lease/Sale Transaction upon UP relative to the pre-transaction going concern value of the line. *See* Crowley V.S. at 7-11. In particular, Entergy submitted evidence designed to show that the revenue stream resulting from the agreement was expected to be more (and, in fact, was more) than what UP would have received had it not divested the line, and that as a result, continued enforcement of the interchange limiting provisions would "overcompensate" UP. *See* Ex Parte No. 575 at 10-11.

Using UP's own pre-transaction analysis as the starting point for his calculations, Mr. Crowley documented that the pre-transaction going concern value for the UP line was {[redacted]}, whereas UP's anticipated net present value of the

Lease/Sale Transaction was {[redacted]}. *Id.* at 11. In addition, Mr. Crowley showed that UP's actual experience under the Lease/Sale Transaction was equivalent (on a pre-transaction net present value basis) to {[redacted]}. *Id.*

On Reply, UP's Mr. Baranowski disputes the relevance of Mr. Crowley's analysis (while overlooking its responsiveness to the Ex Parte No. 575 decision) and quibbles in several respects with Mr. Crowley's approach, but significantly, does not attempt to audit Mr. Crowley's analysis or to perform an analysis of his own.

Mr. Baranowski's protests regarding relevance are inconsequential, his various criticisms of Mr. Crowley's approach are easily disproved, and his failure to engage in his own analysis of the impact of the UP/M&NA transaction constitutes a telling acknowledgement that Mr. Crowley's conclusions should be accepted. *See* Crowley Rebuttal V.S. at 3-11. By way of example, Mr. Baranowski criticizes Mr. Crowley for using an escalation rate to project revenues and costs associated with Entergy's unit train coal traffic (arguing that the escalation rate should be utilized only with respect to the mixed freight and carload traffic on the line) (*see* Baranowski V.S. at 2-3), but Mr. Baranowski ignores the fact that {[redacted]}. *See* Crowley Rebuttal V.S. at 7-8.

Moreover, Mr. Baranowski faults Mr. Crowley for failing to use UP's internal management costs in his analysis (see Baranowski V.S. at 5) notwithstanding the fact that UP refused to provide such data to Entergy in discovery. *See* Crowley Rebuttal V.S. at 10.

Given this absence of a meaningful response to Mr. Crowley's analysis, Entergy respectfully requests that the Board accept Mr. Crowley's analysis as the best evidence of record with regard to the financial impact of the Lease/Sale Transaction.

Finally, UP raises one additional, theoretical criticism regarding Entergy's demonstration under the Board's Ex Parte No. 575 standard. Specifically, UP asserts that there is a tension between Entergy's evidence regarding the use of an interchange commitment to protect value in excess of the pre-transaction going concern value of a line, and Entergy's recognition that there may be some benefits associated with interchange commitments. *See* UP Reply at 28 ("Entergy's experts acknowledge that carriers enter into socially beneficial leases because they expect to benefit, but Entergy says it is unreasonable for carriers to realize those benefits."). This assertion represents a misunderstanding of Entergy's claim.

As Entergy stated in its Opening Evidence, Entergy "does not question that interchange restrictions in agreements relating to the lease or sale of a rail line can play an important role in the development of short-line carriers, and can play an important role in allowing Class I carriers to rationalize their systems and to improve overall service to their customers." Entergy Opening at 2. Consistent with the Board's observation in Ex Parte No. 575, however, Entergy explained that "it is possible for Class I rail carriers to overstep the bounds of reasonableness by imposing restrictions on short-lines that are designed to do more than simply preserve the pre-transaction economic value associated with the divested line." *Id.*

IV. UP's Reply Evidence Fails to Refute Entergy's Demonstration that the Level of the Rent in the UP/M&NA Lease Rent Level is Improperly High

A. Entergy's Opening Evidence

In its Opening Evidence and Argument, Entergy demonstrated that the rental provision in the UP/M&NA Lease was excessive by any reasonable measure. *See* Entergy Opening at 40-50; V.S. Crowley at 12-17. Quoting from Mr. Wilson's deposition in this case, Entergy documented that UP set the rental payment in the Lease at a level that was intended to approximate the total revenues (not the contribution) that UP would lose in the event of a traffic diversion. *See* Entergy Opening at 48-49. In this regard, Entergy suggested that the rental provision was contrary to Missouri legal principles regarding liquidated damages and covenants not to compete. In particular, Entergy cited Missouri precedent supporting the proposition that Missouri law will not tolerate penalty provisions that are intended to coerce compliance with a contractual obligation and to punish any violation of that obligation. *See* Entergy Opening at 40-44 (citing *Restatement (Second) of Contracts* § 356 (liquidated damages are permissible "only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties or proof of loss"); *Abrams v. St. Louis County Library*

Dist. Board, 258 S.W.2d 672, 675 (Mo. 1953) (rejecting penalty provision associated with rental payments under a lease); *Diffley v. Royal Papers, Inc.*, 948 S.W.2d 244, 246 (Mo. Ct. App. 1997); *Muhlhauser v. Muhlhauser*, 754 S.W.2d 2, 5 (Mo. Ct. App. 1988) (provision is unenforceable when it does not measure compensation for breach but instead provides a punishment).

Entergy also discussed the Missouri Court of Appeals' decision in *Muehlebach v. Missouri & K I. Ry.*, 148 S.W. 453 (Mo. Ct. App. 1912), in which the court precluded the enforcement of a "rental" provision in a contract that would have imposed escalating rent levels on a railroad if it failed to relocate its line in a timely manner. *See* Entergy Opening at 42-44. Commenting that it was "manifest" that the payments were not intended to create a genuine lease or to create the relation of landlord and tenant, the court readily identified the "obvious purpose" of the escalating payment levels; namely, coercion of the behavior of the railroad:

> [T]he obvious purpose of providing a progressively increasing scale of monthly payments was to coerce defendant into a speedy vacation of the right of way over that tract and to impose an interminable and ever increasing punishment for a breach of the stipulation, a punishment so harsh and oppressive, so disproportionate to the subject-matter of the stipulation, as to preclude the thought that the parties had in mind the liquidation of the reasonable damages that would be sustained by plaintiffs in consequence of a breach by defendant.

Id. at 43-44 (citing *Muehlebach*, 148 S.W. at 457).

In discussing Missouri precedent regarding covenants not to compete, Entergy showed that Missouri law tolerates only the degree of anti-competitive restriction that is necessary to protect the interest of the contracting party; restrictions that go beyond that degree of protection are not enforced. *See* Entergy Opening at 44-46. For example, the Missouri Court of Appeals held in *Schnucks Twenty-Five, Inc. v. Bettendorf*, 595 S.W.2d 279, 286 (Mo. Ct. App. 1979) that a restrictive covenant "will be upheld if the area to which it refers is not larger than that reasonably necessary to protect the covenantee." *See also Systematic Business Services, Inc v. Bratten*, 162 S.W.3d 41, 49-50 (Mo. Ct. App. 2005) ("The standard for determining the reasonableness of the geographic scope of a restrictive covenant is whether it is no greater than fairly required for protection."); *Sturgis Equipment Company, Inc. v. Falcon Industrial Sales Co.*, 930 S.W.2d 14, 17 (Mo. Ct. App. 1996) (same).

Entergy also showed that the effect of the excessive rental payment levels in the UP/M&NA Lease would be to confer an extraordinary windfall upon UP in the event that M&NA diverted traffic to BNSF. *See* Crowley V.S. at 12-17. In this regard, Entergy also explained that the goal and effect of the excessive rental levels was to "intentionally impose[] a rental obligation upon M&NA that UP knew would coerce M&NA's interchange with UP . . . ." Entergy Opening at 48; *see also id* at 44 ("Much like the improper rental provision in *Muehlebach*, the rental provision in the UP/M&NA

Lease seeks to coerce M&NA to refrain from specified behavior and to punish M&NA for failing to do so.").

B. UP's Reply Evidence

In its Reply Evidence, UP confirmed that its intention was to set the rental payments at a level that would approximate total revenues (rather than contribution) that might be lost through the potential diversion of traffic (*see*, *e.g.*, UP Reply at 34; V.S. Wilson at 13), but UP offered a series of excuses purporting to legitimize the rent level. For example, UP argues that Entergy's discussion of the excessive level of the rent payments under the Lease is merely an effort to "hide the weakness of its complaint" (UP Reply at 2); that evaluation of the rent payments under a liquidated damages standard is inappropriate because the Lease actually constitutes an alternative performance contract under Missouri law (*id.* at 36); that setting the rental payments at the full revenue level was appropriate in any event because of the length of the Lease (*id.* at 36-37); and that UP never actually intended to receive any rent payments from M&NA (*id.* at 9); which, as UP notes, entered the Lease arrangement voluntarily. *Id.* at 32; Wilson V.S. at 17.

UP also suggests that it is reasonable for the Board to permit UP to "err on the high side," in setting the rent, since there supposedly is no harm associated with excessive rent (*see* UP Reply at 35), and UP attempts to reassure the Board that it did not set the rent at an excessive level by explaining that the M&NA vice president who signed the Lease was a former UP employee. *Id.* at 34; Wilson V.S. at 17-18. Finally, UP reverts to its underlying premise in this case in seeking to defend the rent level; namely, that even if Entergy is right that the Lease's rent level is excessive, it does not matter because the absence of pre-transaction competition for service to Independence means that the rental provision has not resulted in the lessening of competition for Entergy service. UP Reply at 31; Wilson V.S. at 14. Rather that legitimizing the paper barrier restriction, however, UP's arguments instead further demonstrate the inappropriateness of the rental obligation and the need for the Board to preclude future enforcement of that obligation.

UP's Reply Evidence regarding the rent level in the UP/M&NA Lease also is notable to the extent that UP's own witness Baranowski must acknowledge the lack of any clear basis for such level. *See* Baranowski V.S. at 7 ("The UP/M&NA approach does not appear to be especially scientific . . ."); *id.* at 8 ("I have no basis for saying that using revenues was the best approach . . .").

C. UP's Efforts to Defend the Rent Level are Inadequate and Irrelevant

As an initial matter, UP's speculation regarding Entergy's motivation for addressing the excessive level of the rental payments in the UP/M&NA Lease is irrelevant and wrong. UP, of course, very much would prefer to transform this case into a referendum on the existence or absence of pre-transaction competition, but inquiry into the excessive nature of the interchange restriction is very much relevant to the central inquiry in this case.

In addition, UP's effort to claim that the Board should ignore liquidated damages precedent and instead consider alternative performance precedent is contradicted by UP's own Reply Evidence and by the terms of the UP/M&NA Lease. Specifically, UP asserts that an "alternative performance contract presents a party with the option of choosing between two alternative obligations, either of which could conceivably prove more desirable." UP Reply at 36 (emphasis added) (citing *Godwin v. Graham*, 228 S.W.2d 789, 794 (Mo. 1950) and 24 Williston on Contracts § 65:7 (4th ed. 2008)). UP's Reply, however, emphasizes that UP never intended or expected M&NA to pay rent. *See*, *e.g.*, UP Reply at 9; Wilson V.S. at 13. Instead, UP intended that the level of the rental payment would preclude M&NA from ever considering the diversion of traffic to BNSF. In other words, it was UP's intention to set the rent at a level that would be sufficiently high as to render one of M&NA's supposed "alternatives" completely undesirable. As such, it is evident that the intention of the Lease was that there would be no genuine alternative for M&NA other than compliance with the implicit obligation to interchange at least 95% of its traffic with UP. Contrary to UP's suggestion, the parties did not contemplate that M&NA might choose between two possible means of performing the contract. In fact, UP's own witness Rubinfeld refers to the rental obligation in terms that strongly suggest that UP regarded M&NA interchange of traffic as an obligation, rather than an option that M&NA might or might not choose to pursue. *See* Rubinfled V.S. at 21 (explaining that M&NA would pay rent in the event it "disregards the interchange commitment," rather than explaining that rent payment was one of M&NA's two legitimate performance alternatives) (emphasis added).

In the absence of a legitimate alternative for M&NA, the proper understanding of the Lease is that it imposes a 95% interchange obligation on M&NA and penalizes M&NA for failing to comply with that obligation. M&NA has no more of a performance alternative than the railroad at issue in *Muehlebach*.[4]

UP also attempts to excuse the excessive level of the rent by explaining that it "never could force M&NA to pay more in rent than UP lost in contribution." UP Reply at 32; *accord* Wilson at 13 ("We cannot force M&NA to pay rent either, since M&NA can always choose to interchange 95% of their traffic with us, as they have done in the past."). The fact that M&NA can choose to interchange traffic with UP is by no means in dispute, and it provides no support whatsoever for the claim that the interchange commitment between UP and M&NA is reasonable. To the contrary, the far more relevant inquiry is whether M&NA can choose to *refrain* from interchanging traffic with UP. Entergy's analysis of the Lease's rent levels and UP's admissions concerning the basis for setting those levels confirm that M&NA realistically does not have such a choice.

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[4] UP's citation of *Godwin v. Graham, supra*, in support of its alternative performance claim is particularly unpersuasive. This case does not provide any meaningful discussion or interpretation of the standards governing "alternative performance" contracts, but instead, merely acknowledges that under the agreement at issue, "appellant had the choice of buying the property *from respondent*, or buying it in partnership *with respondent*." *Godwin*, 228 S.W.2d at 794 (emphasis in original). In the instant case, it is evident that M&NA did not have a genuine alternative.

UP's effort to utilize the 80-year length of the Lease to distract from the unreasonableness of the rent level similarly is unpersuasive. *See, e g.*, UP Reply at 31, 34; V.S. Wilson at 14 ("Given that anything can happen over an 80 year period, a contingent rental schedule based on 1991 gross revenues was as reasonable as any."); V.S. Baranowski at 7 ("While a [rent] figure based on lost revenue might appear high in relation to lost contribution in the early years of the lease, there is no guarantee that the rent amount will remain high relative to lost contribution for the next 80 years."). There is no question (and seemingly no dispute from UP) that the rental provision contemplated rent payments that would have greatly exceeded the loss of contribution associated with traffic diversion at the outset of the Lease. In addition, UP further concedes in its Reply Evidence that {[redacted]}. *See* UP Reply at 34-35; Baranowski V.S. at 7.

Entergy respectfully submits that there is no legitimate basis for arguing that the excessive rent levels in the Lease should be regarded as more tolerable simply because there might come a day in the distant future when they no longer exceed the lost contribution levels. When, and if, that day ever arrives, UP already will have prevented any interchange of traffic far beyond the point where it had recovered its pre-transaction going concern value.

UP also argues that the Board should not question the level of the rent payments under the Lease because M&NA entered into the transaction with UP "voluntarily." *See* UP Reply at 32; Wilson V.S. at 17. This UP observation is irrelevant. The law of contracts regarding liquidated damages provisions and improper penalties is based upon case law in which parties "voluntarily" agreed to provisions that the courts have found to be improper and unenforceable. A contract provision that is void as against public policy is not made less objectionable by the fact that neither party was compelled to sign the agreement against its will.[5]

UP's remaining efforts to defend the rent level in the Lease are similarly without merit. First, UP's argument that the Board should allow UP to err on the side of excessive rent levels (*see* UP Reply at 35) contradicts the Board's obligation to protect the public interest. Entergy respectfully submits that the Board should err in favor of protecting captive shippers from unreasonable practices. Second, there is no validity to UP's familiar refrain that an excessive rent provision is irrelevant in the absence of pre-lease competition. *Id.* at 31. Again, UP's argument contradicts the Board's decision in Ex Parte No. 575 to permit the examination of paper barrier restrictions on a case-by-case

[5] Likewise, there is no merit in UP's effort to assure the Board that the rental provision should be regarded as reasonable because a former UP employee executed the Lease on M&NA's behalf. *See* UP Reply at 34 ("[T]he M&NA vice president who signed the lease was a former UP employee who had supervised UP's analysis of short line spin-offs until he left the company in 1991."); Wilson V.S. at 17-18. The fact that the Lease/Sale Transaction as a whole was acceptable to RailTex does not even prove that the rental provision was viewed by RailTex to be reasonable, much less that it is reasonable and consistent with the public interest from a policy perspective.

basis. UP's premise that no relief from paper barriers ever is necessary or appropriate ignores the Ex Parte No. 575 decision.

* * *

In its Opening Evidence, Entergy explains that in negotiating the Lease with UP, {[redacted]}. *See* Entergy Counsel's Exhibit No. 14.

In a related context, Entergy explained in its Opening Evidence that {[redacted]}. *See* Entergy Opening at 50-53. UP implicitly acknowledges the accuracy and significance of this point in its Reply Evidence by observing that "{[redacted]}." Wilson V.S. at 18 n.12.

V. Witness Rubinfeld's Criticisms of **<u>Entergy's Opening Evidence Are Invalid</u>**

Entergy's Opening Evidence includes the joint Verified Statement of Dr. John E. Kwoka, jr. and Dr. Frederick R. Warren-Boulton. In their statement, Drs. Kwoka and Warren-Boulton analyzed the proper economics-based policy limitations that should apply to paper barriers and the remedy that should be employed in the event that the Board finds that it would be unreasonable to permit the continued enforcement of the UP/M&NA paper barrier. *See* Kwoka/Warren-Boulton V.S. at 2-3.

Drs. Kwoka and Warren-Boulton concluded that paper barriers preserve or even increase allocative inefficiency (*i.e* , the degree to which prices diverge from incremental cost) (*id.* at 3), and they proposed a mechanism for providing relief from unreasonable paper barriers. Specifically, Drs. Kwoka and Warren-Boulton proposed the use of a Shipper Right of Approval ("SRA") as a superior alternative for achieving the efficient use of the transportation resource subject to the paper barrier. *Id.* at 9-13; *see also id.* at 9-10 (discussing the applicability of the Coase Theorem to paper barriers). The SRA would require "joint approval and hence mutual benefit" from any new lease arrangement implemented by UP following a Board finding that the continued enforcement of the current UP/M&NA paper barriers constitutes an unreasonable practice. *Id.* at 11.

In his Reply Verified Statement, UP's witness Professor Daniel L. Rubinfeld argues, *inter alia*, that Drs. Kwoka and Warren-Boulton are mistaken in their analysis because they improperly limit their analysis to "static" (rather than "dynamic") efficiency gains (Rubinfeld V.S. at 2-3, 6-11), and because the paper barrier is essential to prevent "free-riding." *Id.* at 20-22.

In their joint Rebuttal Verified Statement, Drs. Kwoka and Warren-Boulton respond to each of Professor Rubinfeld's objections. Chiefly, Drs. Kwoka and Warren-Boulton demonstrate that allowing UP to appropriate all of the benefits inherent in the short line's operation and precluding Entergy's from sharing in those benefits will not *necessarily contribute to improvement either in economic welfare or dynamic efficiency*. *See* Kwoka/Warren-Boulton V.S. at 1-7. In contrast, recognition of a Shipper Right of Approval ("SRA") will contribute to an overall improvement in economic welfare. *Id.* at 2, 6-10.

In addition, Drs. Kwoka and Warren-Boulton explain that Professor Rubinfeld's criticism regarding "dynamic" efficiency is fundamentally mistaken because: (i) it reflects a misreading of their Opening Statement and overlooks relevant economic evidence (Kwoka/Warren-Boulton V.S. at 2); (ii) an outcome under which both suppliers and their customers gain will result in greater improvements in costs and service than will monopoly retention of excess profits (*id.* at 3); (iii) there is no showing or even claim that UP has used or would use excess profits to foster innovation (*id.* at 4); (iv) he fails to acknowledge that any innovation and cost savings in the present case manifestly are not the result of any expenditure of effort or resources by UP, but instead, are all attributable to M&NA (*id.* at 4-5); and (v) the literature on dynamic efficiency holds that a single-agent market is not as favorable to the process as is a market with multiple centers of innovation. *Id.* at 5.[6]

In their joint statement, Drs. Kwoka and Warren-Boulton also explain that the Lease's contingent rent provisions have operated in an anticompetitive or economically irrational manner. *Id.* at 8. Specifically, they comment upon evidence submitted by Entergy's witnesses demonstrates that there have been several periods when UP was unable to deliver coal to Independence but refused to allow Entergy to divert its traffic to BNSF. *Id.* According to Drs. Kwoka and Warren-Boulton, assuming that such behavior is rational (*i.e* , profit-maximizing), it would "seem to be an investment designed to protect and maintain UP's market power, rather than simple extraction of monopoly profits, and therefore socially undesirable even by Prof. Rubinfeld's standard." *Id.* at 8-9. Drs. Kwoka and Warren-Boulton explain that this behavior provides additional reason to question the reasonableness of the Lease's paper barrier provisions, and further supports the use of a structural solution such as the SRA. *Id.* at 9.

[6] Drs. Kwoka and Warren-Boulton also reject Professor Rubinfeld's criticism of their reliance on the Coase Theorem, observing that they are "unaware of any argument in the economics literature that the Coase Theorem – perhaps the best-known contribution of Prof. Ronald Coase that lead to his winning the Nobel Prize in economics – is insufficiently 'dynamic.'" *Id.* at 10.

VI. The Defendants Improperly Seek to Limit the STB Standards Regarding Entergy's Three Asserted Bases for Relief

In its Ex Parte No. 575 decision, the Board invited shippers to seek relief from paper barriers either by demonstrating that the continued enforcement of the paper barrier violates a provision of the Interstate Commerce Act or by showing that it is appropriate to revoke the exemption through which authority to operate over a line was obtained. In its Opening Evidence, Entergy made these two showings, and in addition, demonstrated that the UP/M&NA Lease constituted a pooling arrangement for which proper agency authorization had not been obtained.

In their Reply Evidence, the Defendants improperly seek to limit the use of these three bases for challenging the continued enforcement of the UP/M&NA interchange commitment.

A. The Continued Enforcement of the Paper Barrier Constitutes an Unreasonable Practice in Violation of 49 U.S.C. § 10702

Entergy's primary request for relief in this case consists of the claim that the continued enforcement of the UP/M&NA paper barrier restrictions constitutes an unreasonable practice under 49 U.S.C. § 10702 and that the Board should act under 49 U.S.C. § 10704 to stop its violation of the Act. *See* Entergy Opening at 33-53. In its Opening Evidence, Entergy explained that the Board's unreasonable practice inquiry is necessarily fact-based and must be tailored to the specific practice at issue. *Id.* at 34 (citing *WTL Rail Corp. – Petition for Declaratory Order and Interim Relief*, STB Docket

No. 42092 (STB served Feb. 17, 2006)). Entergy also noted that the Board had relied upon its unreasonable practice jurisdiction in addressing the railroads' unreasonable practices with regard to the labeling of fuel surcharges that were "designed to recover *more than the incremental cost of fuel attributable to the movement involved.*" *Id.* at 36-37 (citing *Rail Fuel Surcharges*, STB Ex Parte No. 661, at 5 (STB served Aug. 3, 2006)).

In addition, Entergy recounted the exchange between the House Judiciary Committee and the Department of Justice in which Mr. William E. Moschella, Assistant Attorney General, United States Department of Justice explained that if paper barriers were subject to the antitrust laws, they would be evaluated under section 1 of the Sherman Act to determine "whether the restraint is reasonably necessary to achieve the pro-competitive benefits of the sale." *Id.* at 38 (citing September 27, 2004 Letter from William E. Moschella, Assistant Attorney General, United States Department of Justice, to The Honorable James F. Sensenbrenner, Jr., Chairman, Committee on the Judiciary, U.S. House of Representatives, at 2).

In its Reply Evidence, UP raises two principal objections to Entergy's unreasonable practice claim. First, UP suggests that it did not "appear" as though the Board intended to include unreasonable practices amongst the types of violations of the Act that could be the subject of a paper barriers complaint. UP Reply at 22. Second, UP argues that the *DHX v Matson* case[7] demonstrates that UP's continued enforcement of

[7] *DHX, Inc. v. Matson Navigation Co.*, STB Docket No. WCC-105 (STB served Dec. 15, 2004), *aff'd sub nom. DHX, Inc. v. STB*, 501 F.3d 1080 (9th Cir. 2007).

the paper barrier cannot be regarded as an unreasonable practice because UP's intention in imposing the paper barrier was to preclude competition. *Id.* at 22-23. Neither argument is valid.

UP observes that the Board did not specifically list 49 U.S.C. § 10702(2) among the examples of statutory provisions that a shipper might invoke to challenge a paper barrier and suggests that "[t]he Board did not appear to have 'unreasonable practice' claims in mind when it stated that a shipper could attempt to show that an interchange commitment 'is causing, or would cause, a violation of the Interstate Commerce Act.'" UP Reply at 22 (quoting Ex Parte No. 575 at 15). As an initial matter, Entergy notes that the absence of a specific reference to § 10702 in the decision does not suggest that the Board meant to exclude evaluation of paper barriers in response to unreasonable practice claims, particularly where the Board has acknowledged that "[g]iven the diversity among transactions, interchange commitments, and affected parties, we cannot identify every factor that the Board might consider in future cases." Ex Parte No. 575 at 15. Nor does it suggest that the Board lacks authority to consider such a claim.

In addition, UP's assertion regarding the apparent unavailability of relief on unreasonable practice grounds overlooks the fact that the Board's Ex Parte No. 575 decision states that its prefatory discussion "should not be understood as a suggestion that all current and future interchange commitments are necessarily reasonable and in the *public interest* . . . ." Ex Parte No. 575 at 13 (emphasis added). Entergy respectfully submits that the possibility that an interchange commitment may not be "reasonable" is entirely consistent with the suggestion that shippers may seek relief from paper barriers through recourse to the Board's unreasonable practice jurisdiction.

UP's reliance on the *DHX* case likewise is misplaced. In that case, which involved water transportation in the noncontiguous domestic trade, the Board rejected an unreasonable practice claim where the disputed practices involved efforts by the defendant carriers to create more favorable rates and to take other actions to make their services more appealing to potential shippers. Effectively, the defendant carriers had been faulted by a freight forwarder (*i.e.*, a shipper relative to the defendants but a carrier relative to its own customers) for attempting to increase competitive options for the defendants' customers. *Id.* at 3 ("When defendants realized they were losing some of the profits from their [full containerload] traffic to competitors such as DHX – indeed, according to Matson, at one point up to 98% of the revenues from overflow traffic came from freight forwarders – they began taking specific actions designed to induce their FCL shippers to begin dealing directly with them again."); *id.* ("Such actions included adopting tariffs setting up more favorable rates with specific limitations such as shipper name, street address, and zip code; and entering into agreements – typically with large shippers that own the merchandise and have their own logistics departments that manage the transportation and control the routing of their cargo – providing particular rates for specified periods of time."). In the instant case, by contract, UP's disputed practices are of an entirely different character. They are aimed at restricting, rather than enhancing, competitive options for UP's customers. UP's characterization of the *DHX* case as effectively granting immunity to practices aimed at increasing market share is inaccurate.

B. <u>In the Alternative, the Board Should Revoke the Exemption in Part</u>

In its Opening Evidence, Entergy also requested in the alternative that the Board revoke the exemption in Finance Docket No. 32187 to the limited extent necessary to preclude the continued enforcement of the paper barrier restrictions. *See* Entergy Opening at 53-55. Entergy explained that the considerations expressed by Mr. Mohl regarding the construction of a rail spur to Independence are "particularly relevant to the revocation of the exemption" and that revocation would "help to foster the national rail transportation policy and to benefit the public interest by alleviating the need to construct redundant facilities." *Id.* at 55 (citing Mohl V.S. at 8-9).

In its Reply Evidence, UP takes issue with Entergy's effort to seek revocation of the exemption in Finance Docket No. 32187, but UP concedes that the agency invited shippers to petition for revocation of an exemption both in its Ex Parte No. 575 decision and in the *Class Exemption* proceeding on which UP relies. *See* UP Reply at 51 ("In *Class Exemption,* the ICC invited shippers to petition for revocation of an exemption if they believed that a particular transaction was anticompetitive and thus would conflict with the agency's expectation that transactions covered by the exemption would 'maintain the status quo and will not change the competitive situation.'"); Ex Parte No. 575 at 15 (shippers may move "to partially revoke an exemption granted under 49 U.S.C. 10502"). In this regard, the Commission stated in *Class Exemption* that it would reject the argument raised at the time that an after-the-fact remedy would not be adequate to address exempt transactions specifically because of the broad relief that the agency would be willing to afford through revocation:

> Any affected party can file a petition to revoke under section 10505(d) and attempt to show that regulation is necessary to carry out the rail transportation policy. In light of the explicit legislative directive to grant exemptions and then rely on after-the-fact remedies, including revocation, <u>the potential for total or partial reimposition of regulation is always present</u>. Accordingly, we reject protestants' argument that an after-the-fact remedy is not satisfactory. Transactions under this class exemption involve the transfer of discrete, defined property that would not be "lost" in the property of the acquirer. Thus, <u>any transaction could be reversed in whole or in part, and we specifically reserve the right to require divestiture</u> to avoid abuses of market power resulting from the transaction, or to regulate in accord with the provisions of the rail transportation policy.

See Class Exemption, *supra*, 1 I.C.C.2d at 812 (emphasis added).

UP attempts to distinguish this precedent in its Reply Evidence by arguing that the Board's Ex Parte No. 575 decision appeared to contemplate only a limited scope for permissible exemption petitions. *See* UP Reply at 51 (claiming that the Board appears to have intended to limit petitions to reopen regarding paper barriers to claims that the paper barrier removed a competitive option for the shipper). Once again, UP's view of the merits of this case relies upon the improper premise that relief from paper barriers should be precluded for shippers that lacked pre-transaction competitive options. As Entergy has explained above, this premise is inconsistent with the Board's holding in Ex Parte No. 575. The Board decided to engage in case-by-case analysis of pre-existing paper barriers, rather than to adopt the blanket approval of pre-existing paper barriers that the railroad interests had advocated in Ex Parte No. 575. This decision demonstrates that the Board did not intend to impose limitations on the use of petitions for revocation that, accepting UP's characterization for the sake of argument, may have been in place under the *Class Exemption* precedent.

C. The UP/M&NA Lease Constitutes an Unapproved Pooling Arrangement

Entergy's Opening Evidence also demonstrated, in the alternative, that the UP/M&NA Lease constituted a pooling arrangement as to which proper agency authorization had not been obtained. *See* Entergy Opening at 55-59. The Defendants' objections to this argument are easily dismissed.

In its Reply Evidence, UP contends that the Lease does not constitute a pooling arrangement because UP and M&NA are not competitors and because the Lease is not an agreement between competitors to stop competing. UP Reply at 53. Significantly, however, it would be entirely possible for UP to compete with M&NA (in conjunction with BNSF) for long-haul service in the absence of the paper barrier restriction. It is the restriction itself that precludes this competition. Moreover, the Lease precludes competition between BNSF/M&NA and UP for service to Independence, since UP has the right to provide exclusive service to Independence via trackage rights. As such, the fact that UP and M&NA presently do not compete is not proof that the paper barriers in the Lease do not constitute a pooling arrangement. To the contrary, this absence of competition merely demonstrates that the paper barriers have prevented competition that would be present in the absence of those restrictions.

Conversely, M&NA argues that the paper barriers in the Lease do not give rise to an unapproved pooling arrangement because M&NA was not a "carrier" at the time the parties entered into the Lease. *See* M&NA Reply at 13-14 (citing 49 U.S.C. § 11322(a)). M&NA does not cite any authority in support of this novel argument, and M&NA ignores the fact that upon the effective date of the exemption as to which Entergy seeks partial revocation, M&NA became a carrier. Since the UP/M&NA Lease has remained in effect for fifteen years after the date on which M&NA became a carrier (and may extend for an additional sixty-five years into the future), it is evident that the UP/M&NA Lease is an agreement between carriers. As such, M&NA's argument is unavailing and the Board should find that the UP/M&NA Lease did not receive the requisite approval as a pooling arrangement.

VII. Remedies

A. Entergy's Opening Evidence

In its Opening Evidence, Entergy suggested that the Board has broad discretion with regard to the specific relief that it may impose upon a finding that the continuation of the status quo under the Lease is contrary to the public interest. Entergy Opening at 60. In light of that discretion, Entergy presented alternative forms of relief that would be appropriate.

First, Entergy requested that the Board simply preclude UP's continued enforcement of the Lease's paper barrier restrictions, including: (i) the annual rental payment; (ii) the Section 3.01/3.04 right to provide exclusive service to Independence in the absence of Entergy's consent; and (iii) the Section 15.01(f) right to terminate the Lease upon a finding that the provisions of Section IV are unreasonable. *Id.* at 60-61.

Second, Entergy requested in the alternative that the Board preclude enforcement of the paper barrier restrictions in the Lease, but allow UP the option to terminate the Lease and return to its pre-transaction status quo with respect to the leased property. *Id.* at 62. Entergy's discussion of this form of relief included two possible approaches that the Board could adopt in the event that UP opted to negotiate a new lease of the property. In that regard, Entergy explained that: (i) the Board could determine whether the revised lease is consistent with the public interest on the basis of its own review and comments from the public; or (ii) the Board instead could presume that the proposed replacement lease would be reasonable unless shippers who generated at least fifty-one percent of the carloads that originated or terminated on the Line over the preceding twelve months submit comments objecting to the proposed new lease. *Id.* at 62-65. As recounted above, Drs. Kwoka and Warren-Boulton suggest this "Shipper Right of Approval" or "SRA" in their joint Verified Statement. *See* Kwoka/Warren-Boulton V.S. at 9-13.

Third, Entergy requested further in the alternative that the Board should confirm M&NA's obligation to provide a common carrier rate from a point of interchange with a long-haul carrier other than UP with whom Entergy enters into a contract and should preclude enforcement of the rental obligation for service provided in accordance with such a rate. *See* Entergy Opening at 65-66. Entergy explained that this form of relief was consistent with the Board's explanation in Ex Parte No. 575 that the presence of a paper barrier should not be an impediment to the use of a through route involving the tenant carrier if the shipper obtains an upstream contract with a third-party carrier. *Id.* at 66.

B. <u>UP's Reply Evidence</u>

In its Reply Evidence, UP objects to the relief sought by Entergy. *See* UP Reply at 54-63. The primary assertion in UP's Reply is that the relief sought by Entergy is inappropriate and misguided because that relief, if granted, would deprive UP of the benefits it sought to, and did, achieve by entering into the lease with the M&NA. UP further asserts that requiring it to share those efficiency gains with Entergy would destroy UP's incentive to become more efficient and innovative in the future, and the resulting reluctance to improve and innovate would inure to the ultimate detriment of the shipping public generally and Entergy specifically.

Such claims by the railroads that meaningful oversight of their actions and practices are unfair to the industry and will prove to be counterproductive in the long run have been advanced, considered, and rejected previously. Specifically, in *Railroad Cost Recovery Procedures - Productivity Adjustment*, 5 I.C.C.2d 434, 450-54 (1989), *aff'd*, *Edison Electric Institute v. ICC*, 969 F.2d 1221 (D.C. Cir. 1992), the railroads argued "that the adoption of a productivity adjustment to the RCAF would weaken railroads' incentives to improve productivity by increasing the costs and reducing the expected benefits of innovation." *Id.* at 450. The railroads added that if they "perceive that investment in productivity-increasing activities will not improve their earnings, otherwise productive investment will decline, and the Staggers Act goal of an efficiently maintained, privately-owned, revenue adequate rail system will be jeopardized." *Id.*

The Board's statutory predecessor, the ICC, squarely rejected those specious claims. The ICC noted that competitive "markets *require* individual carriers to seek out and implement ways to reduce costs" as "[f]ailure to do so ... would eventually require non-innovative carriers to exit from the market." *Id.* at 452 (original emphasis). The ICC added that "[i]t is hard for us to imagine that railroads would forego important productivity enhancing innovations so that they would not, over time, have to share them with the portion of the market which may be captive." *Id.*

The ICC further found that "[t]he statements by railroad executives suggesting that they would reevaluate investment decisions by reducing the magnitude of the expected benefits if the proposal is adopted are unconvincing." *Id.* at 453. The ICC rejected the notion that carriers would avoid innovations because returns exceeding the industry average would eventually flow through to customers. *Id.* The ICC then explained that the flow-through would not undermine the incentives of revenue inadequate carriers:

> The same problem exists with their assertion that the proposed adjustment would have the greatest negative impact on revenue inadequate railroads. These carriers presumably have powerful incentives to improve their financial condition. Furthermore, the decision of whether or not to invest in productivity enhancing activities is not primarily a function of average return on investment. As witness Kahn for Concerned Shippers explains, a railroad's decision to make investments is a function of the incremental costs and benefits associated with each investment. Thus, a railroad's willingness to undertake productivity enhancing projects only depends on the costs and benefits of those specific projects and not on whether the railroad's overall earnings are inadequate. It is simply not credible that the diffused and non-quantifiable sharing of productivity gains with a limited number of captive shippers would influence a railroad's investment decision-making to the exclusion of all other considerations.

Id at 453-54.

Additionally, it should be noted that the RCAF productivity adjustment entailed a full pass through of productivity subject to a lag. Here, the relief sought by Entergy is purely prospective. Accordingly, UP will have had no requirement to share *any of the gains and benefits that UP garnered during the first fifteen+ years* (1993-2008) of the Lease's operation. Furthermore, even as to the prospective relief actually sought by Entergy through its SRA proposal, UP will not be required to pass through in full the benefits of the lease (as occurs under the RCAF productivity adjustment), but will only be required to convince shippers reflecting 51% of the traffic on the Line that there is sufficient benefit in the arrangement for them to deter their opposition. There is thus no plausible basis for UP's claims that the relief sought by Entergy is inappropriate, unfair, or excessive, or will negate UP's incentives to innovate and become more competitive. All that will occur is that there will likely be *some* sharing of the improved productivity with shippers on the affected segment. That degree of pass through is fully consistent with both competition and sound oversight of practices of regulated firms.

UP's additional objections to the relief sought by Entergy likewise are inapposite. In particular, UP concedes that the Board has the authority to impose conditions upon the approval of line sales and similar agreements, but UP insists that the parties to the transaction must always have the right to walk away if they deem the conditions imposed by the Board to be too burdensome. *See* UP Reply at 54-55; *id.* at 55-56 ("Even to the extent that the Board has the authority to impose conditions on transactions under Section 10901, it still cannot compel the parties to go through with the transaction if they deem the conditions to be too burdensome."). In addition, UP argues that any relief that prevents UP from enforcing the paper barriers that also prevents UP from walking away from the transaction "would constitute a taking of UP's property under the Fifth Amendment" and UP insists that relief in this case would undermine "principles of administrative finality." *Id.* at 56, 57.

Entergy respectfully submits that the demonstration that it has made in this case – namely that UP has recovered a greater value than the pre-transaction going concern value of its line – obviates any concerns regarding a takings claim. Moreover, the ICC's admonition in *Class Exemption* that transactions effectuated under the agency's exemption authority could be subject to subsequent revocation ("in whole or in part") – and the ICC's reference to the "explicit legislative directive" to rely on after-the-fact remedies – resolves UP's expressed concerns regarding administrative finality. In any event, to the extent that the Board finds merit in UP's objections to the first form of relief identified by Entergy, the Board can impose relief in the alternative by permitting UP to terminate the Lease and adopting the SRA approach as a means of evaluating any new proposed lease.

Finally, UP's objection regarding Entergy's request for bottleneck clarification itself recognizes that there are situations in which the UP/M&NA paper barrier could – in the absence of the clarification requested by Entergy – result in a degradation in the ability to obtain STB rate relief. *See* UP Reply at 62 (citing *Bottleneck II*, 2 S.T.B. 235, 243 (1997)). In its decision in *Bottleneck II*, the Board explained that it would require the bottleneck carrier to quote a rate that could be challenged, entirely outside the context of the Board's competitive access regulations:

> Where . . . a shipper first contracts with the origin railroad to carry this "new-origin" traffic to an interchange point on the bottleneck segment, MidAmerican asks [for clarification from the Board]. . . .
>
> . . . Unlike the situation where the bottleneck carrier serves the origin, for service from an origin that it does not serve, the bottleneck carrier's initial routing discretion, including its right to maximize its long-haul . . . is no greater than that of the origin carrier that must also participate in the transaction. As a result, the choice of an interchange for the required two-carrier service in these circumstances cannot be dictated unilaterally by either the bottleneck carrier or, through its contract with the shipper, the origin carrier. Instead, under 49 U.S.C. 10742, the determination of an interchange point for the required through movement is, in the first instance, "a matter of mutual consultation and agreement" between the two carriers. . . .
>
> . . . [I]f the carriers cannot agree on an interchange that would act to create that route, we will determine one.[] That determination would not involve the competitive access regulations.

Id. at 242-44.[8] Consequently, it is evident that the clarification requested by Entergy is relevant to the question of whether the paper barrier at issue in this case has had an adverse impact on Entergy's ability to obtain rate relief from the Board.

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[8] The relief that Entergy seeks also would be appropriate with respect to service from UP-served origins where Entergy is able to obtain a routing order from the Board

C. M&NA's Reply Evidence

In its Reply Evidence, M&NA requests that the Board act with restraint in determining the relief to afford Entergy, and M&NA suggests that "instead of the Board rewriting the contract, a better solution would be for the Board to set forth clear principles governing rental provisions, but leave it to the parties to negotiate the specifics in the Lease." M&NA Reply at 15-16. M&NA's request is in many respects, substantially comparable to the relief that Entergy itself seeks:

> The parties could address the Board's principles in a number of ways, but would arrive at a solution that best fit their needs. If the parties could not agree, then they could submit the dispute to arbitration as provided under section 21 of the Lease. Once the revised provision was agreed upon or arbitrated, it could be presented to the Board for approval, with input from any affected parties.

Id. at 16. Significantly, this explanation contemplates specific guidance from the Board with regard to reasonable interchange commitments, a restructuring of the Lease in accordance with that specific guidance, and the opportunity for affected parties to have some input into the evaluation of the new lease.

While M&NA argues in opposition to the imposition of the SRA as a means of permitting affected parties to provide that "input," M&NA's proposed approach nevertheless invites the Board to require a renegotiation of the Lease and the submission of that new lease for Board approval. *See* Entergy Opening Evidence at 62 (proposing as one of the alternative forms of relief requested by Entergy that the Board make a

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requiring the opening of a BNSF-M&NA route. *See id.* at 240-41.

determination as to whether any new lease is consistent with the public interest "on the basis of its own review and comments from the public (after review of the proposed lease terms)").

M&NA's stated opposition to the SRA proposal argues that it is inappropriate, but Entergy respectfully submits that the SRA approach differs from M&NA's own proposal only in modest respects. In particular, while M&NA proposes that the Board evaluate whether the terms of any new lease are acceptable (with the benefit of "input from any affected parties"), Entergy's SRA proposal simply suggests that the Board rely upon shippers' perspectives or "input" regarding the new lease in deciding whether the terms of the new lease are acceptable. Shippers on the line represent the most direct source of information regarding the public, rather than private, interests associated with any proposed spin-off arrangement.

CONCLUSION

For the foregoing reasons and the reasons set forth in Entergy's Opening Evidence, Entergy respectfully requests that the Board grant the relief identified by Entergy.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 2nd day of September, 2008, caused copies of the foregoing Rebuttal Evidence and Argument to be served upon the parties of record to this case as follows:

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MOHL

REBUTTAL VERIFIED STATEMENT OF WILLIAM M. MOHL

My name is William M. Mohl. On July 11, 2008, I submitted a Verified Statement in support of Entergy Services, Inc.'s ("ESI") and Entergy Arkansas, Inc.'s ("EAI") (collectively "Entergy") Complaint and related Petition for Revocation of Exemption in this proceeding. I have reviewed Union Pacific Railroad Company's Reply submission, including the Verified Statements of Frederick M. Gough and Warren C. Wilson. This Rebuttal Verified Statement will respond to several points raised by these witnesses relating to coal transportation deliveries and reliability concerns.

At the outset, I believe that it is important to note that in responding to my concerns about reliability Mr. Gough is very careful never to discuss UP's obligations under the existing Coal Transportation Agreement between UP and Entergy. Instead, he speaks very generally about UP's "reasonable efforts," and UP's overall "incentives" to deliver as much coal as possible. Lost in this discussion is the very significant commitment that Entergy thought it had from UP – *i.e.*, a commitment to comply with its contractual obligations and stand ready to deliver {[redacted]} of our PRB coal requirements to the Arkansas coal-fired stations.

Utilities enter into fuel supply and fuel transportation agreements for the specific purpose of assuring that there is a reliable source of supply available for those plants. Without a reliable source of supply, the reliability of the plant to generate electricity to serve our customers can be jeopardized. Mr. Gough's entire statement ignores the significance of the long-term contract that Entergy has in place with UP – a contract that we used to think assured us of a reliable supply source. What we now have is a contract that is "suspended" 42% of the time by a Railroad that believes it is enough that they make a "reasonable effort" to deliver coal, while at the same time precluding another carrier from supplementing deliveries during service disruptions through coercive rent penalties

UP's Investment

Mr. Gough states that he takes "exception to Entergy's claims that UP has been reluctant to invest in its coal business " Gough V.S. at 8. He defends UP's investment by noting that since 1984 it has set a series of annual coal tonnage records in 21 of the 23 following years. Between 2000 and 2004, UP's PRB traffic grew 23 percent (from 144 million tons to 177 million tons), and from 2004 through 2006 it grew another 10 percent (from 177 million tons to 194 million tons). *Id* at 8-9.

Over the same periods, however, Entergy has seen significant downward trends in service to our plants. While UP's overall volume (and revenues) have steadily increased over this period, Entergy's deliveries have been well below the contract levels that we bargained for and reasonably expected would be protected. Mr. Gough's growth figures, when compared to Entergy's plight with PRB coal deliveries begs the question – why has Entergy, UP's oldest PRB customer and one of its largest coal shippers, been unable to obtain its contract requirements during this period of great growth?

UP suggests that Entergy's delivery problems stem from its decisions to increase volumes at its Arkansas plants. UP, however, ignores the fact that our contract contemplated these volume levels – levels that have been shipped to Entergy during other parts of the 25 year contractual relationship. UP has always known that Entergy had the right to declare volumes at these levels and should have maintained adequate resources to assure the ability to serve our requirements, regardless of demand from others. Any suggestion that Entergy's "increased demand" was unanticipated is a blatant misstatement of the parties' express written contractual relationship.

Force Majeure

UP also attempts to distract the Board from Entergy's reliability concerns by attempting to downplay the remarkable frequency of its force majeure claims over the three-year period between April 2005 and April 2008. V.S. Gough at 9-11. I noted in my initial Verified Statement that UP had declared Force Majeure 27 times between April 2005 and April 2008, and that the claimed events covered 487.1 days over this period, which meant that UP was operating under force majeure conditions during 45% of the covered time period. V.S. Mohl at 7. During the prior 22 years of the Entergy/UP contractual relationship UP had declared force majeure only 8 times, with only one of these claims (the 1993 Midwestern floods) exceeding a few days. *Id*

Mr. Gough does not dispute this dramatic increase in the frequency of UP's force majeure claims. Instead, he says that Entergy "exaggerates the effect of force majeure" and that we "double-count days where more than one force majeure declaration was in effect." V.S. Gough at 9-10. He also attempts to minimize the impact of a force majeure claim by claiming that even though UP's contractual obligations are suspended during a force majeure, UP is still obligated to use reasonable efforts to deliver coal.

As the person responsible for assuring the reliability of coal supply at our coal-fired generating stations, I strongly disagree with Mr. Gough that it is possible to overstate the effect of a force majeure on reliability concerns. During such periods, it is essential for Entergy to pursue all reasonable options for supplemental deliveries. As both Mr. Gray and I explained, the UP/M&NA lease restrictions present a serious impediment to these efforts, in that they virtually assure that the only supplemental deliveries we can ever receive are deliveries that include participation in the movement by UP (*i.e.*, the party that would be claiming inability to deliver in the first place).

Further, Mr. Gough's effort to suggest that the scope of UP's force majeure claims are exaggerated is in itself a serious overstatement. Mr. Gough does not dispute that both the number of claims and the days under which UP claims force majeure exist have dramatically increased in recent years. He does not offer any rebuttal to Entergy's evidence that the number of claims has gone from eight (8) in 22 years to 27 in three (3) years. Instead, he quibbles with the calculation of the total number of force majeure days involved in these 27 claims.

I asked my staff to recheck their calculations. The initial analysis was intended to exclude overlapping events. Mr. Gough is correct that we inadvertently double-counted some days in the analysis. We have reviewed the data and confirmed that instead of the 487.1 days of force majeure I referenced in my opening verified statement, UP *only* declared force majeure 461.7 days over the subject three-year period. (Exhibit WMM-2). Accordingly, instead of claiming force majeure for 45% of this period, when the correct number of force majeure days are included it turns out UP was claiming its contract obligations were suspended by force majeure for *only* 42% of the time.

Mr. Gough also criticizes Entergy's inclusion of certain Colorado force majeure claims in its discussion of UP's new-found zeal for claiming force majeure. Mr. Gough believes that these force majeures should not be included because the bulk of coal received in Arkansas is PRB coal. First, it is noteworthy that very few of the force majeure days that we calculated related to Colorado events. Of the 487.1 days of force majeure I referenced in my opening verified statement, only 42.7 days relate to Colorado force majeure events. Most of these days were concurrent with PRB force majeure days and were thus not added to the PRB force majeure days. My revised calculation of 461.7 force majeure days *does not include* the concurrent Colorado days.

Second, the only reason Entergy was buying Colorado coal was because of our concerns regarding reliability of UP's PRB service. Force Majeure claims affecting Colorado deliveries that were needed to supplement UP's poor PRB service are just as relevant to our reliability concerns as Force Majeure claims impacting PRB coal deliveries directly. Again, a viable M&NA option would have helped us supplement deliveries during these extended periods when UP was claiming its contract obligations were suspended.

Actual Coal Deliveries

UP also defends its service reliability based on the view, as expressed by Mr. Gough, that Entergy should be content to receive a "fair share" of the "available" coal. Our agreement with UP does not call for them to deliver percentages of non-binding NCTA forecasts and does not relieve them of the obligation to deliver our declared tonnages because of commitments UP, and/or the coal mines, may have made to other customers. It calls for UP to deliver {[redacted]}. All of the events that UP now attempts to suggest reduce their obligations under the Agreement may sound reasonable, but UP offers no factual support that warrants the conclusion that their contractual delivery obligation is reduced or worse, suspended. Commitments that mines may have made to others have no bearing on UP's delivery obligation to Entergy. If a mine is truly incapable of loading our coal, then UP has remedies under the contract – remedies that it has rarely exercised during my tenure at Entergy.

Entergy has also learned from experience that UP's idea of "reasonable efforts" during a force majeure does not provide any basis to assume that service will be reliable. We have been through two very expensive and hard-fought litigations with UP over service issues. In an unconstrained world, one would expect that the railroad would have an incentive to deliver as much coal as possible to every customer. That is true because the incremental contribution on a ton of coal is presumably better than no contribution on that coal if it can be delivered. The problem we have experienced firsthand, however, is that when the resources become strained, as they did in both 1997-1998 and 2005-2006, UP no longer has as much incentive to deliver lower contribution traffic under legacy contracts. As Mr. Gray details in his Rebuttal Verified Statement, when delivery levels are compared to contract nominations it is clear that UP's service has been anything but reliable.

Entergy Is Not Looking For a Free Ride

I also take strong exception to UP's suggestion that Entergy's pursuit of paper barrier relief is driven by Entergy's desire for a "free ride " This is an unfair characterization of both the marketplace and the realities of the service situation that we have been in for the last several years. Far from looking for a free ride, Entergy is more like the bus passenger that paid full-fare for a guaranteed seat on bus A that the driver claims he has no firm obligation to make available 42% of the time, while bus B with empty seats is waiting to carry them to their destination, only to find that the owner of bus A has a deal with the owner of bus B that precludes bus B from providing service. UP appears to be saying that the Board should turn its head on this scenario and require us to build or buy our own bus – a bus that would be duplicative, expensive and in the interests of no one except UP. Entergy has paid *Billions* of dollars to UP over the last 25 years. We should not have to bear additional costs to build a duplicative track because UP refuses to allow alternative service when it is unwilling, or unable, to provide the service itself.

I also disagree strongly with UP that our dealings with BNSF in any way reflect on our degree of "confidence" in UP Entergy has found itself between the proverbial rock and a hard place in obtaining coal deliveries to Independence and White Bluff. It is no secret in the marketplace that rail rates have risen substantially since Entergy first entered its coal transportation agreement for these plants.[1] As one of the few legacy contract holders remaining, Entergy's contract with UP should have great value. However, UP has made clear through its repeated attempts to invoke Force Majeure that they would prefer not to deliver under the terms of this agreement.

In a constrained marketplace, like the one that has existed the last three years, UP has every incentive to short the legacy contract customers in favor of the newer contract or circular traffic {[redacted]}. Under these circumstances, the fact that Entergy chose not to divert tonnages to BNSF and instead opted to press UP to deliver all of the tonnages that it

[1] Mr Gough notes at pages 2-3 that Entergy's current rates (adjusted in real-dollar terms) are below the rates that UP was paying before UP entered the lease with M&NA. Entergy never suggested that the M&NA lease had any causal impact either way on rail rate levels The current rate levels reflect {[redacted]}. As I note elsewhere in my statement, it has been painfully obvious that UP is unhappy with these rate levels and we believe these unsatisfactory rate levels have been a serious impediment to receiving reliable transportation service at times when UP's resources have been constrained

committed to deliver under the terms of the Coal Transportation Agreement should not be viewed as a vote of confidence in UP. Rather, Entergy's "choice" to try to get the benefits of the bargain it struck with UP makes perfect market sense. Simply stated, Entergy should not have to pay BNSF more for service that UP is obligated to provide at a lower price, but no longer wants to provide.

VERIFICATION

STATE OF TEXAS }
} ss:
COUNTY OF MONTGOMERY }

WILLIAM M. MOHL, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated. Further, I certify that I am qualified and authorized to file this statement.

William M. Mohl

SWORN TO AND SUBSCRIBED

before me this 29 day of August, 2008

Daisy S Pettitt
Notary Public or Official

DAISY S. PETTITT
Notary Public, State of Texas
My Commission Expires
January 27, 2012

EXHIBIT WMM-2

REDACTED

GRAY

REBUTTAL VERIFIED STATEMENT
OF
DANIEL B. GRAY

My name is Daniel B. Gray. I am the same Daniel Gray that submitted a Verified Statement in this proceeding on July 11, 2008. I am submitting this Rebuttal Verified Statement in response to the Verified Statement that Mr. Frederick M. Gough submitted on behalf of Union Pacific Railroad Company ("UP") on August 11, 2008.

Mr Gough refers to "three situations over the past fifteen years." The "three situations" that we raised were not short-term events. The first two of these events (the 1993-1995 event and the 1997-1998 event) resulted in Entergy being shorted more than {[redacted]} tons. That is enough coal to run the one of the Arkansas coal plants for {[redacted]}. The more recent event that was described in part by my opening Verified Statement, and in part by Mr. Mohl's opening Verified Statement, covered a three-year period from April 2005 through April 2008. During this period, Entergy was shorted nearly {[redacted]} tons, which would be enough to run one of our Arkansas plants for {[redacted]}. These "three situations" are not trivial events – they affected performance in *nine of the fifteen* years between 1993 and 2008, and have had a major impact on our operations and the way we do business.

__1993-1995__

In addressing my comments on the 1993 to 1995 service disruptions, Mr. Gough stated that I was wrong in suggesting that the UP/M&NA Lease caused or contributed to the service problems Gough V.S. at 3. I don't know what Mr. Gough is referring to when he makes this claim, and he does not refer to a specific point in my Verified Statement. Regardless, Entergy never said that the UP/M&NA Lease *caused* the service problems that we experienced in 1993-1995. However, the paper barrier constraints in the Lease most certainly did impair Entergy's ability to obtain alternate coal supplies to cover for the UP delivery shortfalls.

Mr. Gough altogether mischaracterizes the events and deceptive methodology through which UP refused to waive the restrictions to the UP/M&NA Lease. Gough V.S. at 3-4. Mr. Gough says that "Entergy is wrong when it claims that UP refused to waive the UP-M&NA Lease's interchange commitment to permit delivery of additional coal to Independence using a Burlington Northern/M&NA routing." UP never outrightly refused Entergy's request in so many words. Instead, a careful reading of UP's letter of May 24, 1994 (referenced by Mr. Gough as his exhibit FMG-1) reveals that UP induced Entergy to withdraw its request for the waiver *as a condition to* UP's "propos[ed] plan for increasing its coal deliveries to Entergy's Independence and White Bluff plants" (Gough Rebuttal, third paragraph under "The 1993-1995 Midwest Flooding and Aftermath").

In the first paragraph of that letter, UP stated the "Railroads are prepared to..." take certain actions which Mr. Gough refers to as the proposed plan. This clearly indicates that no commitment had yet been made. In the next-to-last paragraph of the same letter, UP stated that "Based on the Railroads' commitment to this program, it is our understanding that Entergy is withdrawing its request for . . [the waiver]." Finally, in the final paragraph of the same letter UP requested Entergy's written confirmation of that understanding. Entergy withdrew its request under duress with the mistaken belief that UP's proposed actions would, in fact, increase UP's coal deliveries to Entergy as represented by UP. Although Entergy was briefly "pleased with the railroad's efforts," as

Mr. Gough notes, this reaction was very short-lived. As history shows, UP's deficits continued to build *at an increasing rate* for the remainder of 1994, and continued through 1995.

It is true that Entergy "withdrew" the request for a waiver of the M&NA restriction in connection with UP's assurances to Entergy that it would take steps to supplement deliveries to the Arkansas plants. The fact that we withdrew the request based on those assurances, however, did not change the fact that UP was unwilling to grant our request for a waiver. In this regard, I note that neither UP nor M&NA refuted my testimony that an M&NA representative told me that M&NA would not be able to participate in an M&NA/BNSF movement because of the lease. Gray V.S. at 6. In sum, the withdrawal of the request did not change the fact that UP would not agree to waive the lease restrictions.

I also would like to reemphasize that, while Entergy was *initially* encouraged upon receiving these assurances from UP in May 1994, any satisfaction soon dissipated when UP's service continued to deteriorate through the remainder of 1994. There was also no point in renewing the request at that time, as UP had made very clear to Entergy that it was not going to waive the M&NA restriction under any circumstance.

1997-1998

In my opening Verified Statement I explained the circumstances surrounding Entergy's attempts to obtain supplemental coal deliveries via the M&NA during the 1997-1998 UP service meltdown. Gray V.S. at 7-8. I referred specifically to correspondence between UP and Entergy, as well as to Entergy submissions to the Board. Mr. Gough's reply Verified Statement responded to that testimony with two points: (1) a claim that our requests for M&NA access related to the White Bluff plant; and (2) a claim that Entergy "benefited" from the UP/M&NA relationship because UP ultimately rerouted empty Independence trains via the M&NA during the crisis. Both of these claims merit clarification.

First, Mr. Gough is wrong that our request for M&NA related only to White Bluff. My opening Verified Statement included Entergy's 1997 petition for emergency relief that was filed in connection with Finance Docket Nos. 32760 and 32760 (Sub-No. 21). Gray V S at Exhibit DBG-4. As reflected in the correspondence attached as exhibits to that pleading, Entergy requested that UP "provide information with respect to any restrictions that may exist with respect to the M&NA's delivery of coal to White Bluff in connection with BNSF, and to waive such restrictions." *Id.* at Exhibit CWJ-1, page 2. This reference to "White Bluff" was an obvious typographical error, as the context of the rest of the letter, including the immediate sentence, plainly confirms. M&NA did not and could not serve the White Bluff plant, and as such, it would have been immediately evident to UP that our request for information about restrictions on M&NA's ability to deliver coal to Entergy actually sought information regarding the Independence plant. In addition, the next sentence in Mr. Jewell's letter states that UP was "also" requested to provide Entergy with a rate for the movement of coal to White Bluff. Again, this additional request for a rate for the White Bluff plant confirms that our immediately preceding inquiry regarding M&NA related to the Independence plant. UP's suggestion to the contrary in its Reply Evidence ignores this unmistakable fact. In any event, I was personally involved in discussions relating to this option with UP and can confirm that UP never agreed to waive the M&NA restrictions to allow such a movement to Independence.

Second, Mr. Gough's suggestion that Entergy "benefited" from the UP/M&NA relationship is, at best, a generous characterization of the facts. It is true that UP eventually was able to route empty trains from Independence over the M&NA to Kansas City. What is not true is that this act eliminated the need for BNSF/M&NA service. It is also incorrect to suggest that the re-route provided substantial benefits during the height of UP's meltdown. Our experience reflected the opposite. In the first re-route effort in the late fall of 1997, Entergy noticed that the re-route actually *increased* cycle times. UP was effectively using the M&NA lines as a parking lot and parking Entergy's trains on the M&NA in order to limit congestion at its Kansas City terminal. As a result, UP was able to report to the Board that its car inventory in Kansas City was declining (implying service was improving), while in reality our cars were stuck on the M&NA and our overall cycle time performance and deliveries were declining. Entergy agrees with Mr. Gough that eventually the use of the M&NA re-route was beneficial. However, the benefits of this reroute did not favorably impact cycle times until later in 1998.

UP's actions in 1997-1998 further underscore the problem with the UP/M&NA Lease. In a time of severe constraint, UP once again made very clear that Entergy *could not* pursue any alternative that could provide substantial benefits unless UP controlled the movement. Mr. Gough fails to explain to the Board that even with the steps that UP was taking to try to minimize its contract breaches, it still fell short of its delivery obligation by more than {[redacted]} in 1997-1998. Had it allowed us to use M&NA/BNSF to supplement deliveries, there is no doubt we could have mitigated some of these deficits.

2005-2006

Neither M&NA nor UP has offered any facts to rebut my comments concerning discussions that I had with M&NA personnel about whether UP would allow M&NA to assist during UP's latest service crisis. Gray V.S. at 9-11. Mr. Gough, who was not involved in any of those discussions, does not offer any proof that my recitation of the dealings with M&NA is inaccurate. Instead, Mr. Gough simply notes that we did not ask UP for a waiver. We believed it would be premature to approach UP on this matter until we learned from M&NA whether the move would be feasible from a practical standpoint and the extent, if any, to which the paper barrier would impede the move Mr. Gough's statement does not contradict in any way my statements about what M&NA told Entergy about UP's unwillingness to waive the lease restrictions.

M&NA's counsel, who were also not involved in my discussions with M&NA personnel, suggest that Entergy did not provide necessary information that would allow M&NA to provide a quotation. As I detailed in my opening Verified Statement, we repeatedly informed M&NA that the types of operational questions they were asking needed to be referred to KCS because Entergy simply did not have and could not produce this information. V.S. Gray at 10. I believed then, and believe now, that repeatedly directing these inquiries to Entergy was designed to stall and discourage our efforts to obtain service from M&NA. *Id.*

Mr. Gough also attempts to defend UP's unwillingness to waive the M&NA lease restrictions by noting that UP offered to waive the volume limitation under the Coal Transportation Agreement to allow BNSF to deliver more coal to White Bluff based on UP's force majeure claim. We disputed the legitimacy of the PRB force majeure claim. We repeatedly asked UP to provide support for its claim, especially as to reasons for the alleged track failures on the Joint Line. Entergy never received an adequate response. Given that it was our view that the delivery obligation was not suspended, we did not want UP to be relieved of that obligation. We wanted what we bargained for in signing our contract – performance. Absent UP's willingness to perform under the terms of the Agreement, Entergy needed to have access to all alternative transportation options, not just the ones that would benefit UP.[1]

I also strongly disagree with Mr. Gough's statements concerning how cooperative UP was in connection with the efforts to bring in foreign coal to Independence in 2006. Mr. Gough suggests that the request for UP's cooperation on foreign coal was unrelated to the service problems because Entergy had made a corporate decision to diversify its fuel supply This testimony ignores the very real fact that Entergy's decision to diversify was forced on it by UP's performance failures under the PRB Coal Transportation Agreement.

I also disagree with Mr. Gough's suggestion that UP's performance was strong in 2005-2006. His calculations of UP's performance in 2005-2006 are fraught with errors. His numbers ignore contractual provisions and substitute numbers from sources that are not relevant. He gives UP credit for disputed force majeure claims, including 196 days to catch up on track maintenance in the PRB, that have the effect of understating UP's performance failures.

As I detailed above, UP did not deliver anywhere near the percentages they claim when their performance is measured against the only relevant measuring stick – the

[1] UP could have benefited by being relieved from the volume obligation because it could have then used any available capacity to move higher revenue traffic for others, without being in violation of the Entergy Agreement. Entergy did not believe it was in our best interests to provide this disincentive to perform.

contract. When compared to that standard the facts are that UP fell short of its delivery obligation by {[redacted]} tons in 2005, and {[redacted]} tons in 2006. That translates to delivery of only {[redacted]} of our declarations in 2005 and only {[redacted]} of our declarations in 2006. It should be noted that the 2006 numbers reflect improved performance in the latter part of the year. The 2007 and 2008 numbers averaged in the {[redacted]} range when compared against contract declarations.

VERIFICATION

STATE OF TEXAS }
} ss:
COUNTY OF MONTGOMERY }

DANIEL B. GRAY, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated. Further, I certify that I am qualified and authorized to file this statement.

Daniel B. Gray
Daniel B. Gray

SWORN TO AND SUBSCRIBED

before me this 29 day of August, 2008

Daisy S Pettitt
Notary Public or Official

DAISY S. PETTITT
Notary Public, State of Texas
My Commission Expires
January 27, 2012

CROWLEY

REBUTTAL VERIFIED STATEMENT

OF

THOMAS D. CROWLEY

My name is Thomas D. Crowley. I am the same Thomas D. Crowley that submitted an opening verified statement ("OVS") in this proceeding on July 11, 2008. I have been asked by Counsel for Entergy Arkansas, Inc. ("EAI") and Entergy Services, Inc ("ESI") (collectively referred to as "Entergy") to respond to the verified statement of Union Pacific Railroad Company ("UP") witness Michael Baranowski filed in this proceeding on August 11, 2008.

As explained in my OVS, the Surface Transportation Board ("STB" or "Board") decided to examine interchange limiting provisions or "paper barriers", such as the rental payments contained in the UP/M&NA Lease/Sale Agreement, on a case-by-case basis to ascertain the reasonableness of a specific provision. The standard set forth in the Board's decision in Ex Parte No. 575, *Review of Rail Access and Competition Issues – Renewed Petition of the Western Coal Traffic League*, served October 30, 2007 ("*Rail Access*") states that reasonableness of interchange limiting provisions will be determined based upon an examination of the net present value ("NPV") of the contribution resulting from a line sale or lease transaction compared with the expected contribution had the transaction not occurred.

In my OVS, I demonstrated that the NPV of the contribution resulting from the Lease/Sale Transaction at issue in this proceeding exceeds the expected contribution had the transaction not occurred under three different scenarios, i.e., 1) UP's October 1992 analysis of the NPV of cash flows; 2) UP's October 1992 analysis supplemented to include Entergy's traffic;

and 3) the pre-transaction NPV of the cash flows associated with the actual historic traffic that moved under the Lease/Sale Agreement through 2007.

In addition, I demonstrated that under three different hypothetical scenarios where M&NA interchanges a portion of traffic with a carrier other than UP, that the resulting cash flows (including a rental payment pursuant to the Lease Agreement), also exceed those UP would have received had it not entered the transaction. These three hypothetical scenarios were: 1) all Entergy traffic is received by M&NA from a railroad other than UP; 2) all KCPL traffic is received by M&NA from a railroad other than UP; and 3) all non-unit coal train traffic currently interchanged with UP, where UP is a bridge or overhead carrier, is diverted to a carrier other than UP.

Mr. Baranowski takes exception to my results, finding them "unremarkable" and "unreliable". However, Mr. Baranowski's statement and his criticisms of my analyses ignore the basic premise of the STB's standard for determining the reasonableness of an interchange limiting provision. In addition to disregarding the STB's standard, Mr. Baranowski's statements and opinions ignore UP's own evidence in this proceeding and are unsupported by any analysis or probative evidence

I will summarize my critique of Mr. Baranowski's verified statement under the following topical headings:

A. Mr. Baranowski Disregards the STB's Standard for Determining the Reasonableness of an Interchange Limiting Provision

B. Mr. Baranowski Ignores UP's Own Document Production in this Proceeding

C. Mr. Baranowski Fails to Offer Any Analysis or Support for His Claims

D. Conclusion

A. MR. BARANOWSKI DISREGARDS THE STB'S STANDARD FOR DETERMINING THE REASONABLENESS OF AN INTERCHANGE LIMITING PROVISION

The Board states in *Rail Access*:

> But a carrier considering a line sale or lease of a line with traffic that makes a revenue contribution presumably calculates the net present value of the stream of revenue contribution from the traffic it would be forgoing and either (a) demands an equivalent value in the sale price or rental fee, or (b) includes interchange limiting provisions in the sale or lease. ***The revenue stream resulting from the agreement should be no more than what the carrier would have received had it not divested or leased the rail facilities in question,*** or had it demanded more in the sale price or rental fee. ***So long as that is the case, the interchange limiting provisions would not overcompensate the carrier....***[1] Emphasis added.

The STB standard set forth above clearly contemplates that reasonableness will be determined based upon an examination of NPV of the contribution resulting from a line sale or lease transaction compared with the expected contribution had the transaction not occurred.

Mr. Baranowski repeatedly disregards this standard. First, in contrast to this standard, Mr. Baranowski characterizes my conclusions that the NPV of the revenue contribution from the Lease/Sale Transaction exceeds that which UP would have received had it not entered into the Lease/Sale Transaction under each of the three scenarios to be "unremarkable".[2] While Mr. Baranowski may believe my conclusions are unremarkable, the STB stated that this type of analysis is relevant to determining whether an interchange restriction in a lease or sale agreement is reasonable Therefore my undisputed findings are key to a finding of unreasonableness in this

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1/ *Rail Access* at 10-11

2/ Baranowski at 2.

proceeding. As described in greater detail below, Mr. Baranowski offers no analysis to refute my application of the Board's standard.

Next, Mr. Baranowski states that my conclusions that UP earned more by entering into the Lease/Sale Transaction than had it not entered into the transaction was somehow faulty because it is based on what UP *expected* to earn rather than what it actually earned.[3] Again, Mr. Baranowski ignores the STB's standard in *Rail Access*. The STB's standard set forth above presumes the rail carrier considering a line sale or lease:

> "....calculates the net present value of the stream of revenue contribution from the traffic it would be forgoing...."[4]

Calculation of the net present value of the contribution a carrier would forego is, by definition, an *ex ante* calculation and is based on what is *expected* rather that what is known. UP's own argument filed on August 11 in this proceeding recognizes the Board's requirement that "the competitive effects of interchange commitments had to be viewed "*ex ante* (i.e., before the sale or lease of the facilities)."[5] Mr. Baranowski's allegation that my analysis is lacking because it is based on expected results rather than actual results is inconsistent with the STB's standard and with UP's own argument.

Mr. Baranowski argues that an interchange limiting provision based on UP's anticipated total revenue (rather than the net revenue or contribution) from traffic to be handled by the lessee "makes sense" given that the Lease Agreement at issue in this proceeding would remain in place

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3/ Id.

4/ Ibid, footnote 1

5/ UP argument, p. 21.

for as long as 80 years. Again Mr. Baranowski, ignores the STB's standard. The Board is particularly concerned with Agreements of long duration or those which go on in perpetuity. The Board states at page 15 of *Rail Access*: "The parties to the transaction and other concerned parties should expect a higher level of scrutiny on agreements that contain a total ban on interchange with other carriers or go on in perpetuity." From a net present value perspective, a lease of 80 years is, in effect, in perpetuity.

The STB specifically states that the analysis is based on the NPV of the "contribution" the carrier would be foregoing, not the "revenue" it would forego. Mr. Baranowski's conclusion that use of total revenue "makes sense"[6] and that he has "no basis for criticizing it"[7], is in direct conflict with the reasonableness standard set forth by the Board.

Mr. Baranowski also alleges that were M&NA to acquire the line today, UP would be expected to set the sale price based on its expected future earnings and that "Past earnings are entirely irrelevant".[8] Mr. Baranowski again demonstrates his lack of regard for the STB's standard. This proceeding involves a 15-year old agreement, not a new or proposed transaction. Since the Board's standard requires an *ex ante* evaluation of interchange limiting provisions, an examination of what was expected at the time of the transaction is required.

Mr Baranowski further demonstrates his disregard for the *ex ante* nature of the STB's standard in his argument related to the "loss" UP would have incurred had it based the rent on lost contribution at the outset of the Agreement. Mr. Baranowski contends that – had the parties

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6/ Baranowski at 7

7/ Id at 8

8/ Id at 6

projected the contribution in 1992 and set the rent payment on this basis – UP would receive only {[redacted]} in rental payments even though UP's actual contribution has grown to {[redacted]}. Mr. Baranowski apparently fails to comprehend that the evaluation of an interchange limiting provision focuses on the information and expectations of the parties at the time the agreement is signed, in this instance the {[redacted]}. The fact that UP actually realized more than what it expected over the past 15 years could not have been known in 1992 and cannot, therefore be used to justify the level of the interchange limiting provision today. In addition, I am not suggesting a carrier may not earn more than its ex ante NPV, but only that it may not rely on an interchange restriction in order to generate earnings above that level.

Finally, Mr Baranowski dismisses my analysis regarding UP's contribution from rental payments pursuant to the Lease Agreement saying that he understands that, at M&NA's option, it has never interchanged sufficient levels of traffic to trigger a lease payment and, as a result, no such payments have ever been made. Mr. Baranowski thus concludes that shippers on the line are therefore no worse off than had UP not entered into the transaction. Mr. Baranowski fails to recognize that it is precisely because the rental payments are so confiscatory, that the M&NA has effectively been prevented from exploring routing alternatives.

B. MR. BARANOWSKI IGNORES UP'S OWN DOCUMENT PRODUCTION IN THIS PROCEEDING

In addition to disregarding the STB's standard as set forth in ***Rail Access***, Mr. Baranowski ignores UP's own evidence in this proceeding. As described in my OVS, I accepted UP's economic analysis of the after-tax NPV of cash flows based on UP's expectation of the going concern value of continuing to operate the Carthage Line compared with the cash flows from entering into the Lease/Sale Transaction.[9] As also explained in my OVS, even though UP's analysis excluded APL's coal traffic, from the outset of the implementation of the Lease/Sale Transaction, UP has elected to interchange APL's coal traffic to M&NA for delivery to Independence. I therefore revised UP's analysis to include Entergy's traffic in order to demonstrate the pre-transaction NPV value of the Lease/Sale Transaction as implemented by the parties. My calculations relied on UP revenue and cost information for Entergy's traffic and UP's economic model which it provided in discovery in this proceeding.[10]

Mr. Baranowski takes exception to my revision to UP's analysis, alleging that I simply assumed that, had UP included the APL coal traffic in its analysis, it would have applied the same projections regarding revenue and cost changes to the Entergy traffic that UP applied to the traffic it actually analyzed. Mr. Baranowski states that my application of UP's projections to Entergy's traffic is questionable as all of Entergy's traffic is unit coal train traffic, while much of the other traffic is mixed freight including sand, grain, soybeans, etc.[11]

Mr. Baranowski's argument is inconsistent with the discovery material provided to Entergy in this proceeding and referenced in my OVS. {[redacted]

9/ Crowley OVS at 8

10/ Id. at 9

11/ Baranowski at 3

[redacted]}.

Mr Baranowski implies that I should have excluded from my analysis the {[redacted]} M&NA paid to UP to purchase the portion of the Carthage Line between Bergman and Guion, Arkansas. Again, Mr. Baranowski's argument is contradicted by UP's own internal documents. UP's original analysis demonstrating the NPV of the benefits of this transaction {[redacted]}[12] (Emphasis supplied).

Mr. Baranowski's suggestion that my analysis should {[redacted]}.

Mr. Baranowski states that my analysis is unreliable because I was "forced" to change UP's assumed discount rate in its NPV calculation from 13 percent to 12.5 percent. Mr.

12/ Discovery document UP-HC-0000303.

Baranowski's observation is misplaced for at least two reasons. First, UP provided its NPV analysis without any supporting documentation or demonstration of how it performed its calculations. Upon request for additional information, UP failed to provide any additional information as to how it performed its analysis. {[redacted]}. Because of UP's failure to provide support for its analysis, I had only UP's results and a few cryptic footnotes which accompanied UP's results to estimate how UP performed its calculations.

As stated in my OVS, by using a 12.5 percent discount rate (which also rounds to 13 percent), I was able to very nearly replicate UP's result. The fact of the matter is, use of the 12.5 percent discount rate replicates UP's result, whereas use of the 13 percent discount rate does not. Mr. Baranowski would have the Board believe that it is more important to rigidly rely on UP's rounded discount rate that produces a different result than that found in UP's analysis, rather than to use an unrounded discount rate that reproduces UP's result. Stated differently, Mr. Baranowski finds the input is more important than UP's result and would choose to ignore UP's result in order to make the false claim that my analysis is unreliable.

Mr. Baranowski's observation is also misplaced because he does not properly interpret UP's discount rate. {[redacted]}. As stated above, I have simply used 12.5 percent which must be used to replicate the results of UP's analysis.

C. MR. BARANOWSKI FAILS TO OFFER ANY ANALYSIS OR SUPPORT FOR HIS CLAIMS

Mr. Baranowski fails to provide any analysis or support for his various claims and therefore his statement is not meaningful to this proceeding. Mr. Baranowski contends that my comparison of UP's pre-transaction analysis with the NPV of cash flows from the actual historical traffic is an "apples to oranges" comparison because UP's analysis uses internal management costs and my analysis relies on Uniform Railroad Costing System ("URCS") costs. While Mr. Baranowski alleges an apples to oranges comparison, he does nothing to demonstrate any impact resulting from this alleged error. Mr. Baranowski does not attempt to demonstrate any differences between UP's internal management costs and URCS costs or to quantify the impact of comparing UP's analysis with my analysis.

Mr. Baranowski's allegation is unfounded as Entergy requested access to UP's internal management costing system in this proceeding in order to understand the basis for UP's estimates of contribution. UP vigorously opposed providing its internal management costs and the STB denied Entergy's motion to compel UP to produce this information.[13] It is inappropriate for UP to refuse to provide Entergy information in discovery and then to criticize Entergy for not using the withheld information in its evidence.

13/ See the STB's decision in this proceeding served May 7, 2008 at 4.

As stated previously, Mr. Baranowski alleges that my results are not reliable because I changed UP's discount rate from 13 percent to 12.5 percent, yet Mr. Baranowski does not provide any support for UP's NPV calculations Entergy requested this support in discovery, and it requested this support again in the deposition of UP witness Wilson. Mr. Baranowski now states that my analysis is unreliable, but does not provide any information to support UP's actual calculations. Mr. Baranowski's criticism is unjustified given that neither UP nor Mr. Baranowski has provided a thorough explanation of the factors, assumptions and calculations supporting UP's analysis.

Mr. Baranowski questions my reliance on {[redacted]}. Again, in spite of this criticism, Mr. Baranowski provides no evidence to demonstrate that the use of UP's projections is inappropriate for application to Entergy's traffic or to recalculate my estimates using any other forecast data. Rather, Mr. Baranowski merely makes unsupported allegations.

D. CONCLUSIONS

In offering criticism of my OVS and its supporting analyses, Mr. Baranowski disregards the STB's standard for evaluating interchange limiting provision of Lease and Sale Agreements among carriers, chooses to ignore the evidence submitted by UP (or the documents produced by UP) in this proceeding when it benefits his argument and fails to support any of his statements by demonstrating errors in my analysis or by offering a revised or "corrected" analysis to replace my analysis. Mr. Baranowski simply submits argument with no substance, and as a result his statement offers no value to this proceeding.

VERIFICATION

STATE OF VIRGINIA)
)
CITY OF ALEXANDRIA)

THOMAS D. CROWLEY, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated. Further, I certify that I am qualified and authorized to file this statement.

Thomas D. Crowley

Thomas D. Crowley

KWOKA/WARREN-BOULTON

REBUTTAL VERIFIED STATEMENT

John E. Kwoka, jr.
Frederick R. Warren-Boulton

I. Introduction and Summary

1. My name is John E. Kwoka, jr. I am the Neil F. Finnegan Professor of Economics at Northeastern University. I have previously submitted a Verified Statement jointly with Frederick R. Warren-Boulton in this proceeding. My qualifications and curriculum vitae were provided at that time and are incorporated by reference herein.

2. My name is Frederick R. Warren-Boulton. I am a principal at MiCRA, an economics consulting firm in Washington, DC. I have previously submitted a Verified Statement jointly with John E. Kwoka, jr , in this proceeding. My qualifications and curriculum vitae were provided at that time and are incorporated by reference herein.

3. We have been asked by counsel for Entergy to comment on the economic arguments made by the Union Pacific Railroad Company ("UP") in opposition to Entergy's request that the Surface Transportation Board review the reasonableness of the paper barriers contained in the interchange agreement between the UP and the Missouri & Northern Arkansas Railroad ("M&NA"). In particular, we have been asked to evaluate the arguments made in the Verified Statement of Daniel L. Rubinfeld submitted as a response to our earlier Verified Statement.

4. In our earlier statement, we explained that while paper barriers allow the realization of costs savings and other innovations from shortline railroads, they do so in a manner least beneficial to society. Paper barriers permit retention of all the benefits by the incumbent

monopoly railroad--the very entity whose higher costs and lack of innovation constitute the rationale for shortlines. That retention of all benefits by the incumbent simultaneously ensures that the shipper receives none of any benefits that might accrue and, contrary to the arguments of Prof. Rubinfeld, also reduces the incentive for innovation in this market. For these reasons, we concluded that under paper barriers the market outcome diverges sharply and unnecessarily from both the competitive benchmark and from the regulatory standard of reasonableness.

5. We proposed a method of ensuring that, when prospective benefits arise as a result of the efforts of a shortline railroad, the incumbent railroad still gains – after all, it cannot be forced into any agreement–but that the benefits are shared by shippers, who may in turn choose to reward the innovating shortline in order to generate further gains. Our proposed Shipper Right of Approval ("SRA") would achieve this meritorious objective without the administrative burden of the current system, thus completing the picture of a superior outcome and a superior process.

6. Prof. Rubinfeld contends that our analysis is incomplete and therefore incorrect. The reason it is incomplete, in his view, is that it "focuses entirely on the issue of 'static efficiency' [whereas] in setting policy it is essential to focus also on 'dynamic efficiency'," which he defines as "long-run benefits...when firms have incentives to invest and innovate." The difference between the two types of efficiency, according to Prof. Rubinfeld, is that a dynamic perspective recognizes that "[a]llowing firms to extract and retain static 'surplus' [i.e., profit] is appropriate and even essential to promoting long-run dynamic efficiency." He also argues that our Shipper Right of Approval is nothing more than a "free-riding" "revenue grab" by Entergy that would "further diminish railroads' incentives to invest and innovate" (p. 3).

7. That argument misreads our economic statement and overlooks some relevant economic evidence. We are entirely concerned with maximizing total benefits from the organization of production–both present and future. As economists, we have no special expertise nor do we offer any views as to the preferred distribution of those benefits across market participants, whether to railroad or utility shareholders or to consumers of electric power. Economic theory, confirmed by a large body of empirical evidence and by experience in this industry, however, establishes that an outcome under which both suppliers and their customers gain will result in greater improvements in costs and service than will monopoly retention of excess profits. The very dynamic efficiency that Prof. Rubinfeld asserts we ignore is in fact enhanced under our proposal.

8. In what follows, we elaborate on these simple points. We conclude that our original position remains correct, and indeed is even enhanced by a proper interpretation of Prof. Rubinfeld's stated concern over dynamic efficiency.

II. Economic Analysis of Efficiency from the UP/M&NA Lease

9. As noted, Prof. Rubinfeld's basic argument is straightforward. He contends that any firm, having legitimately acquired its market power through "skill, foresight, and knowledge" (p. 6), can do anything that more fully extracts profits so long as it does not weaken or eliminate competitive constraints imposed by a particular rival. Moreover, he claims, such excess profits are necessary rewards for the effort and risk-taking associated with investing in quality improvements and cost savings (pp. 9-10) Any disruption would "chill...long-haul carriers' willingness to pursue socially beneficial investment and initiative" (p. 13). He relates this

depiction to standard analysis in antitrust economics (p. 7), and cautions that violating such principles would be "bad economics and bad public policy" (p. 25).

10. We disagree with his portrayal of the facts in this industry and with his interpretation of the economic evidence. Even if it were the case that the UP's current monopoly position were the result of its own heroic efforts–unlikely in any meaningful sense, given the long and complicated history of this industry, including a large number of mergers–his conclusion that the UP is entitled to any profits that might subsequently come its way or that it might figure out how to extract is incorrect. The relevant regulatory standard governing practices in this industry is "reasonableness," and the Board's decision in Ex Parte No. 575 makes clear that there is some limit to the extent to which an incumbent Class I railroad can extract all of the potential profits, and prevent the customer from receiving any of the benefits, associated with selling or leasing a segment to a short-line operator. Our analysis was based on this reasonableness principle, not on the unilateral right of extraction urged by Prof. Rubinfeld.

11. Moreover, Prof Rubinfeld's concern over the utility of such excess profits in fostering innovation and investment is misplaced in three important respects. First, there is nothing in his statement, in the lease, or in reality that requires the UP to invest any of the added profit that it is extracting on innovation of any sort. Nothing suggests that it might do so, or even that it might be in its interest to do so It is simply an additional revenue stream from existing assets. UP can use those additional profits however it wishes, including for shareholder dividends or buybacks or managerial perquisites such as stock options. For these reasons, whether one wishes to term this a windfall or not, Prof. Rubinfeld's effort to connect profits from this lease to future innovation is unsupported.

12. Secondly, in the present case the innovation in question manifestly is not the result of any expenditure of effort or resources by UP. The cost savings, the quality improvement, the service innovations are all attributable to the M&NA. {[redacted]} It is the M&NA that brings them into being with its operation. The UP continues to set the price, but then collects the added profit from the M&NA's cost innovation and effort.[1] This is true of shortlines in general, as acknowledged both by the Board in its October 2007 decision in Ex Parte 575 and by Prof. Rubinfeld, who terms that decision a "sound statement" of the benefits of shortlines (p. 17). Yet the further implications of this fact are not noted in Prof. Rubinfeld's discussion.

13. Thirdly, the literature on the economics of "dynamic efficiency"—investing for the purpose of cost-reducing or quality-improving innovation--holds that a single-agent market is not as favorable to the process as is a market with multiple centers of innovation. The reason for this is simply that the single agent faces no competition and therefore has diminished incentive for innovation that disturbs or displaces its existing operations and profit. Even Schumpeter—cited approvingly by Prof. Rubinfeld--did not so much urge pure monopoly for purposes of innovation as caution that an excessively fragmented industry would not maximize innovation.[2] Economic

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[1] We are not proposing any windfall gain to the M&NA. Neither we, nor the UP, nor shippers, nor society in general have any interest in establishing the MN&A as a "second monopolist" The UP by itself (not with the MN&A) would continue to set the through rate for deliveries to Entergy. It is important to note, however, that that only ensures that prices to shippers do not rise further because of the lease. But preventing things from becoming even worse cannot be termed a concession or an improvement for shippers. It is simply what continues to be in UP's self-interest.

[2] J. Schumpeter asserted that "we have got to accept ...that [the large-scale

theory beginning with Arrow[3] and later extended in many directions has convincingly established this proposition. But excessive fragmentation is hardly the concern here. In addition, a large empirical literature confirms that markets with multiple centers of innovation offer the best prospects for research, development, and innovation generally.[4] Prof. Rubinfeld's attempt to make some general case for allowing the unconstrained exercise of monopoly power due to unspecified "dynamic" considerations and effects on investment in innovation is thus without foundation.

14. Thus, Prof. Rubinfeld's favorable portrayal of the UP/M&NA lease is based on a series of assertions that do not reflect all the facts of this case or all the relevant economics. As we have pointed out, there is no "dynamic" argument to counter the "static" gains from a SRA. We are left with the fact that, as a matter of economics, the UP has no incentive to pass through any of its lower costs resulting from the lease to its captive shippers. This is in marked contrast

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establishment] has come to be the most powerful engine of [economic] progress...In this respect, perfect competition is...inferior..." *Capitalism, Socialism, and Democracy*, 3rd ed., 1950, p. 101.

[3] K. Arrow, "Economic Welfare and the Allocation of Resources for Innovation," in *Rate and Direction of Inventive Activity*, NBER, 1962

[4]F. M. Scherer's survey of the evidence concludes, "A bit of monopoly power in the form of structural concentration is conducive to invention and innovation, particularly when advances in the relevant knowledge base occur slowly. But very high concentration has a favorable effect only in rare cases, and more often it is apt to retard progress by restricting the number of independent sources of initiative and by dampening firms' incentives to gain market position." *Industrial Market Structure and Economic Performance*, 3rd ed., p. 660 This view is seconded by Cohen and Levin, who report "little support for the view that industrial concentration is an independent, significant, and important determinant of innovative behavior and performance." "Innovation and Market Structure," in *Handbook of Industrial Organization*, v. 2, 1989, p. 1078. See also P. Aghion, N. Boom, R. Blundell, R. Griffith and P. Howitt "Competition and Innovation: An Inverted-U Relationship," *The Quarterly Journal of Economics*, CXX, 2, May 2005, 701-728.

to the usual case--not only in competition but also in unconstrained oligopoly or even monopoly--where suppliers find it in their self-interest to respond to a reduction in their variable costs by lowering prices, and where shippers could thus be assumed to benefit to some extent even without a provision such as a SRA. Under the specific conditions of this case, however, the UP has simply taken advantage of its monopoly status to extract further profits from shippers. Absent some provision such as the SRA, it can be expected to pass through none of the gains, an outcome which is neither necessary nor desirable.

III. Economic Analysis of Related Competitive Issues

15. Prof. Rubinfeld's statement addresses several other issues concerning the competitive implications of the lease and our proposal that deserve response. We discuss these in turn.

16. Prof Rubinfeld portrays the "rent-free" aspect of the lease as pro-competitive and the UP Reply Brief goes so far as to describe it as "enhanc[ing] competition for shippers" (Reply Brief, p. 14). But these claims fail to recognize that the lease is "rent-free" if and only if the M&NA agrees to the key provision of the lease, which is intended to prevent competition from the M&NA. Better stated, the rent waiver is part of an all-or-nothing offer to not compete. The part of the lease that offers consideration to the lessor cannot be described independently of the quid pro quo. Moreover, the reason that M&NA has never paid any rent is that the rental provisions are prohibitively expensive, so that by design the M&NA ordinarily interchanges at

least 95% of its traffic with the UP.[5] That was, by its own admission, the UP's original intent (UP Reply Brief, p. 9).

17. Prof. Rubinfeld also asserts that the rent level is irrelevant for competition purposes because in no event will shippers be "in a less favorable intramodal competitive posture than they would have been under continued UP operation" (p 21). That claim is unfounded. If UP had retained the line, it should have still been willing to accept diversion of the Independence traffic under the Efficient Component Pricing Rule, that is, so long as UP were made whole for contribution lost as a result of the diversion. That possibility is effectively negated under the prohibitive rent provision of the lease since M&NA is required to compensate UP for its lost revenues and not merely its lost profits. Thus the rental provision serves to prevent diversions that would be helpful, or at least non-harmful, to UP, M&NA, and Entergy simultaneously.

18. In that regard, we understand from the statements of Entergy's company witnesses that there have been several periods when UP was unable to deliver coal to the Independence plant, yet UP refused to allow Entergy to divert its traffic for transportation via BNSF. Assuming this behavior is rational (i.e., profit-maximizing), it would seem to be an investment designed to protect and maintain UP's market power, rather than simple extraction of monopoly profits, and therefore socially undesirable even by Prof. Rubinfeld's standard. This is a further reason to question the reasonableness of the rental rate charged by UP and an argument for a structural solution such as the SRA.

19. Moreover, the shortline cannot be said to enhance competition. While its service partially replaces the UP, it lacks true independence. That service originated only with the

[5] We understand that the UP has on occasion granted waivers to the M&NA for traffic that it could not serve. It is, of course, not that traffic that the UP is determined to control.

consent of UP. The rate to Entergy continues to be set solely by the UP rather than by both the UP and the MN&A (presumably, to prevent successive monopoly), and the UP can terminate the arrangement at its discretion. UP's monopoly power with respect to local traffic is transferred to M&NA, but even that, it must be presumed, is in return for other concessions in the overall agreement with the UP. Such a shortline operates very much at the suffrage of the long-haul carrier. It cannot be said to bring independent competition to the route--in the sense of a seller that competes price down by offering a substitute--but rather as an economic complement to the UP. Indeed, if something more than that--true competition--were in the offing, the UP would never permit it to arise in the first place.

20. Prof Rubinfeld also claims that our proposed Shipper Right of Approval is nothing more than an effort to wrest some concessions from the UP on behalf of Entergy, as if lower prices to shippers, increased output and higher social welfare were somehow objectionable on "dynamic" grounds. The SRA simply ensures, however, that the monopoly railroad does not use its incumbency to stymie competition and innovation, to exploit new revenue sources without limit, and to flaunt the regulatory standard of reasonableness. Nothing in the SRA would undermine incentives for innovation, since the shipper has every interest in any cost-saving, quality-improving innovation. The shipper would not demand anything that jeopardized such an innovation, since that would injure itself. And even if shippers were somehow initially unable to understand the benefits to them from allowing the UP to appropriate all the gains from the lease, surely the appropriate solution would be for the UP simply to better explain to the shippers why it is in their best interest to allow the UP to do so.

21. Finally, Prof. Rubinfeld's reading of the Coase Theorem and our reliance on it is mistaken. While the Coase Theorem does imply that transactions costs may justify intervention in markets, the major point of Coase's contribution was the proposition that we stated: If transactions costs are not an impediment, any initial allocation of the property rights to some asset does not affect its final use. Our proposal was to reduce transactions costs so that the optimal outcome would emerge even if the initial allocation were slightly altered. The SRA avoids cumbersome administration while ensuring optimal allocation. By contrast, Prof. Rubinfeld's endorsement of the current process would maintain high transactions cost and regulatory uncertainty. In fact, he appears to recognize this defect with the current arrangement in his statement that there "may be static efficiency gains from eliminating such [transactions] costs." (p. 25).

22 Prof. Rubinfeld makes one further claim, namely, that the Coase Theorem is in any case part of an outmoded static way of viewing markets. We are unaware of any argument in the economics literature that the Coase Theorem – perhaps the best-known contribution of Prof. Ronald Coase that led to his winning the Nobel Prize in economics – is insufficiently "dynamic." Nor has Prof. Rubinfeld made any such case. There is nothing in the assumptions, the model, or the implications of the Coase Theorem that is restricted to statics. It simply offers insights into market processes, whether those markets are for current goods and services, future goods and services, or the connections between the two (that is, resources required for technological progress). Under appropriate circumstances, which our proposal seeks to establish, assets will end up where they are most useful, and hence where they are most valued The Coase Theorem speaks to our circumstance and objectives as readily as others.

IV. Conclusions

23. UP's Reply Brief (p. 2) and Prof. Rubinfeld's statement (p. 2) both repeatedly cite our statement that the lease agreement is socially beneficial.[6] But neither the Reply Brief nor Prof. Rubinfeld's statement acknowledges the equally important second part of what we observed–that the lease confers all of the benefits on a single party, the UP. That outcome is inconsistent with both the economics of dynamic efficiency and the regulatory standard of reasonableness. Our proposal would remedy this imbalance and do so in a manner that is administratively efficient.

[6] It would be more accurate to say that for purposes of this filing, we assume that the lease is socially desirable, but do not provide any independent basis for such a finding. In particular, while the lease can be assumed ex ante to benefit the UP and provide at least a competitive return to shareholders of the MN&A, there may be third-parties, e.g., labor, and perhaps even shippers, who are worse off because of the lease. In particular, to the extent that some of the cost savings are "pecuniary" efficiencies (e.g., lower prices for inputs such as labor) rather than "real" efficiencies, an agreement that benefits only some parties to a transaction cannot be assumed to be socially beneficial. One advantage of a "right of approval," of course, is that it ensures that those agreements will be socially desirable.

VERIFICATION

I, John E. Kwoka, jr., declare under penalty of perjury that the foregoing Statement is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on August 29, 2008

John E Kwoka Jr

JOHN E. KWOKA, JR.

VERIFICATION

I, Frederick R. Warren-Boulton, declare under penalty of perjury that the foregoing Statement is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on August 28, 2008

FREDERICK R. WARREN-BOULTON