

F.D. 30400 - 4/9/85 - Pgs. 9865-9923

BEFORE THE
INTERSTATE COMMERCE COMMISSION

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In the Matter of: :

SANTA FE SOUTHERN PACIFIC CORPORATION : Finance Docket

 -- CONTROL -- : 30400 et al.

SOUTHERN PACIFIC TRANSPORTATION :

 COMPANY :

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Hearing Room A
12th & Constitution, N.W.
Washington, D.C.
Tuesday, April 9, 1984

The hearing in the above-entitled matter was
convened, pursuant to recess, at 9:30 a.m.

BEFORE:

JAMES F. HOPKINS,
Administrative Law Judge

00210000

1 APPEARANCES:

2
3 (As heretofore noted.)
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C O N T E N T S

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WITNESS

DIRECT CROSS REDIRECT RECROSS

Thomas J. Fitzgerald			
By Mr. Nelson	9868		
By Mr. Auerbach		9869	
By Mr. Livingston		9937	
By Mr. Kharasch		9953	
By Mr. Leary		10039	
By Mr. White		10051	
By Ms. Reed		10052	

E X H I B I T S

<u>NUMBER</u>	<u>IDENTIFIED</u>	<u>RECEIVED</u>
MKT-C-62 & 63	9956	10057
MKT-C-64 & 65	9957	10057
MKT-C-66	9958	10057
MKT-C-67	9958	10057
MKT-C-68	10052	

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P R O C E E D I N G S

1
2 JUDGE HOPKINS: Let's call the hearing to
3 order.

4 I am not going to take appearances again,
5 because it just adds to the record and everything
6 anyway. I think I know everybody and everybody knows
7 everybody else here.

8 This is a continuing hearing in Finance Docket
9 Number 30400, Santa Fe Southern Pacific Corporation
10 Control, Southern Pacific Transportation Company.

11 Are there any preliminary matters that the
12 parties have? I have a few preliminary matters.

13 MR. NELSON: I have just one announcement I
14 would like to make on the record as to the change in the
15 order of witnesses, which I thought we ought to do at
16 the outset here.

17 The first one is D.G. McInnes, which had been
18 set for -- I think it was April 17, but he appears 9th
19 on the list. We would like to move McInnes to the
20 position just before R.M. Champion, which is the last
21 witness.

22 And the other change is D.E. Mader, which is
23 Witness 12 now. We would like to place Mader after L.G.
24 Simpson. That is all I have.

25 JUDGE HOPKINS: Any other preliminary

1 matters? Let's go off the record a minute. I know you
2 are all waiting with baited breath about the furlough
3 plans of the ICC.

4 (Whereupon, a discussion was held off the
5 record.)

6 JUDGE HOPKINS: Let's call the first
7 witness.

8 MR. NELSON: Mr. T.J. Fitzgerald, please.
9 Whereupon,

10 THOMAS J. FITZGERALD
11 was called as a witness, and having been first duly
12 sworn, took the stand, and was examined and testified as
13 follows:

14 DIRECT EXAMINATION

15 BY MR. NELSON:

16 Q Mr. Fitzgerald, would you please state your
17 name and title and business address for the record?

18 A Thomas J. Fitzgerald. My title is vice
19 president, traffic, of the Atchison, Topeka, and Santa
20 Fe Railway Company. My business address is 80 East
21 Jackson Boulevard, Chicago, Illinois, 60604.

22 MR. NELSON: Your Honor, Mr. Fitzgerald's
23 statement in response to the filings of the responsive
24 applications appears in SRSP-43, and has been served on
25 the parties. I understand Mr. Wilson has distributed to

1 the reporter and others separate sets for their
2 convenience.

3 There is one modest errata -- the errata has
4 also been served on the parties -- to Mr. Fitzgerald's
5 statement which -- the errata appear in SFSP-48. Mr.
6 Fitzgerald's correction is changing a citation on Page
7 9. I think all the parties have that.

8 BY MR. NELSON: (Resuming)

9 Q Mr. Fitzgerald, you have before you the
10 statement, Verified Statement of Thomas J. Fitzgerald
11 appearing in SFSP-43?

12 A I do.

13 Q As changed by the errata that constitutes your
14 testimony in this proceeding?

15 A It does.

16 JUDGE HOPKINS: Who is going to start? Good.

17 CROSS EXAMINATION

18 BY MR. AUERBACH:

19 Q I am Joseph Auerbach. I represent the Kansas
20 City Southern.

21 A Good morning, sir.

22 Q You have stated in your verified statement
23 that the purpose of your testimony is to present general
24 policy considerations that led you to your conclusions.
25 Whose general policy considerations are those, Mr.

1 Fitzgerald?

2 A They are the general policy considerations of
3 the applicants in this proceeding.

4 Q How were they determined?

5 A Through consultation with the top management
6 of the two companies and its counsel.

7 Q When you say top management, do you include
8 the board of directors?

9 A Not to my knowledge, no. I am speaking of the
10 officers.

11 Q As far as you know, there has been no further
12 discussion since the beginning of this case with your
13 board of directors. Would that be fair?

14 A I don't know one way or the other.

15 Q Do you remember as exhibit in this case,
16 KCS-C-1, which was a covering letter of May 16 on
17 stationery of Santa Fe Industries, Inc.?

18 A Yes.

19 Q There is a statement there about the small
20 team of Santa Fe people who contributed to the study.
21 Were you a member of that small team?

22 A No.

23 Q Did you contribute in any way to this study?

24 A I think some of my people may have been asked
25 to contribute data, but there is nothing formal that

1 involved any of us.

2 Q Do you know who the members were of the small
3 team?

4 A My recollection is that the project leader was
5 Terry Booth, and at least one of the members of the team
6 was Bob Keyes. I think I testified earlier that one of
7 the members of my staff was detailed away to work on the
8 assignment, and his name is Bob Zdanky. I don't know
9 who else may have been involved.

10 MR. NELSON: Excuse me, Mr. Auerbach. I don't
11 know how many questions you have like this, but this
12 subject matter, I think the precise questions you are
13 asking were posed by Mr. Kharasch of Mr. Fitzgerald when
14 he was on the stand the first time. You may not have
15 been aware of that.

16 MR. AUERBACH: Certainly Mr. Kharasch would
17 not have been aware of the policy considerations that
18 are being testified to today when he asked those
19 questions.

20 JUDGE HOPKINS: Go ahead, Mr. Auerbach.

21 BY MR. AUERBACH: (Resuming)

22 Q Do you know if any members of that small team
23 were consulted in connection with the policy
24 considerations to which you have testified today?

25 A No, I wouldn't say that any of those people

1 make policy. Now, they may have been consulted in the
2 ordinary course of conversations, but I would say as a
3 general rule nothing formalized.

4 Q How about yourself? Were you consulted?

5 A With respect to what?

6 Q With respect to the general policy
7 considerations that led to your testimony here today.

8 A I participated in those discussions.

9 Q With whom?

10 A Various times I participated in discussions
11 with Mr. Schmidt, Mr. McNear, Mr. Cena, various
12 attorneys and senior officers of both companies and of
13 the holding company. Mr. Krebs would be another one.
14 Mr. Denton, Mr. Adam.

15 Q When did these conversations occur?

16 A They take place from time to time.

17 Q Have any occurred since February 19, 1985?

18 A I don't know. I suppose.

19 Q Did you have your testimony here reviewed
20 before it was put in final form by any other persons you
21 have mentioned as having participated in the policy
22 determinations?

23 A I did not. I cannot say, however, that it may
24 not have been reviewed pursuant to something that
25 counsel may have been involved in.

1 Q Did you prepare the testimony yourself?

2 A I prepared it in consultation with my
3 counsel. I did not write it.

4 Q At any time when you were preparing this with
5 counsel, did you raise any question about any policy
6 determination to which you were testifying here?

7 A Any question? I think we discussed what the
8 various themes were to be of this statement. I can't --
9 I don't know that I could be any more specific in
10 answering your question.

11 Q Would you say it is fair to say that counsel
12 told you what the policy considerations were?

13 A No, I don't think that would be fair.

14 Q Do you know whether there has been any
15 determination as to what conditions might be acceptable
16 to the applicants if imposed by the commission?

17 A There have been numerous discussions along
18 those lines.

19 Q Can you tell us what conditions would be
20 acceptable?

21 A I can tell you that any conditions, if
22 imposed, might contribute to a decision to not go
23 forward with the merger.

24 Q Can you tell us the nature of the "any
25 condition" to which you have just referred?

1 A Let me try to answer it this way. As I think
2 we have indicated, this merger as we see it is by no
3 means a sure-fire success.

4 Any burden above and beyond simply the burdens
5 that are inherent in the operations of the two companies
6 are just another straw that you lay on the camel's
7 back.

8 Which particular straw is the one that breaks
9 the camel's back and would cause us to go not forward
10 with the merger is not really something that we have
11 been able to determine.

12 Number One, at this point we cannot quantify
13 all of the costs that any particular condition might
14 impose. Number Two, we have to really take as the
15 starting point from which we determine, will this thing
16 work, at any rate the day on which we get the authority
17 to proceed with the merger.

18 So, what I am saying is that we realize that
19 overall the success of this post-merger company is
20 already at the margin, and if we impose any additional
21 costs or burdens on it, we are going to, I think, very
22 quickly reach the point where we can't go forward.

23 Q Assume with me that the Commission imposes
24 conditions which you find unsatisfactory. Would the
25 Santa Fe stay in the railroad business then?

1 A You mean the Santa Fe Railroad or the Santa Fe
2 Southern Pacific?

3 Q I am speaking of the Santa Fe Railroad.

4 A That is all we have is a railroad.

5 Q You have spoken about the consequences under
6 those circumstances being devastating in what you
7 referred to as the somewhat longer run. What period of
8 time did you have in mind?

9 A The long run keeps getting shorter all the
10 time, Mr. Auerbach. I would say the next major business
11 downturn might cause us to be chased from the field.

12 Q Could you measure a business downturn in terms
13 of a trend or a period?

14 A Well, I said major business downturn. I am
15 talking about a recession.

16 Q As a matter of fact, Santa Fe has done better
17 than railroads nationally even through the last
18 recession, haven't they? I am speaking of the railroad
19 when I say Santa Fe.

20 A Understand that that is damning with faint
21 praise. The railroads generally have done very poorly
22 through the last recession, and haven't come out of it
23 very well.

24 Q Wouldn't it be true that the last 50 years
25 railroad ton miles have about doubled?

1 A I don't know. We don't measure success on ton
2 miles. We measure it on profitability.

3 Q How about growth in traffic. That would have
4 a bearing on profitability, wouldn't it?

5 A No, it wouldn't.

6 Q No bearing?

7 A Well, if you don't have any business, you
8 don't have any profits, but it certainly doesn't excite
9 me to think in terms of ton miles. I would rather think
10 in terms of dollars and cents.

11 Q How about growth in traffic. Have you had
12 that in the last few years?

13 A No.

14 Q Have you had more than any other railroad in
15 the west?

16 A I don't think so. We have had a decline in
17 traffic. The best year traffic-wise we ever had was
18 1980, and it has been downhill since then, Mr. Auerbach,
19 downhill.

20 Q Since 1980?

21 A Yes, sir.

22 Q Let's go back to a little longer trend. Let's
23 say since post-World War Two. Would you characterize
24 the Santa Fe's record during that period as excellent?

25 A As opposed to trucks?

1 Q Just, did you have an excellent record during
2 that period?

3 A No.

4 Q Would you characterize your growth in traffic
5 volume during that period as superior?

6 A If you look strictly at traffic volume and not
7 at dollars, I would say that we have had a growth of
8 traffic. I would not call it superior.

9 Q If those two terms were used to your board of
10 directors, then, following the submission to them of
11 what is now KCS-C-1, that would be incorrect, wouldn't
12 it, in your judgment?

13 A Yes.

14 Q Since this application was in its genesis
15 stage between the two railroads, has Santa Fe been able
16 to meet the Union Pacific's expense levels about on a
17 parity?

18 A I am sorry. Could you restate that?

19 Q Have you had about the same expense levels as
20 UP since about 1981?

21 A I don't know. Maybe you can help me with that
22 question. I don't know what expense levels the Union
23 Pacific has.

24 Q Well, in order to determine rate of return,
25 you have to know your own expense levels. You do know

1 those, don't you?

2 A Sure.

3 Q Would you agree that the major shortcoming
4 which led to this proposal is the Santa Fe's inability
5 to attain an attractive return on investment?

6 A I would say that is part of it. Another part
7 of it is the general trend toward concentration in the
8 railroad industry which is going to make it increasingly
9 difficult to even hold our own in the years ahead.

10 Q Don't you think that is summed up in the
11 phrase "attractive return on investment?"

12 A Well, I don't think so, no. It is the reason
13 I added what I did.

14 Q If you were asked again, because I want you to
15 define what you mean by it, whether you would be
16 satisfied with an attractive return on investment, how
17 would you define attractive?

18 A I would be satisfied with anything that
19 approached our ability to cover our full costs in an
20 economic sense.

21 Q You wouldn't compare it to any other
22 industry?

23 A No. In an economic sense it doesn't matter
24 what industry you are in.

25 Q Even though rails have a particular advantage

1 that other industries do not have in competing?

2 A You need to tell me what that advantage is. I
3 am not aware of it.

4 Q You have trucks on the ground that nobody else
5 has.

6 A Well, that is as much a liability, sir, as any
7 sort of an advantage. We have got all kinds of tracks
8 out there that aren't being used. When a trucker's
9 business all of a sudden goes away from where he has it
10 he can pick that truck up and take it somewhere else and
11 stay in business.

12 When I have a piece of railroad it is
13 committed to a particular piece of land. I would not
14 call that an advantage. That is a very inflexible kind
15 of a thing.

16 Q Do you believe that there is ease of access to
17 the rail industry by anyone who wants to get into it?

18 A Who would want to get into it?

19 Q Just answer the question, if you please. Do
20 you believe that there is ease of access?

21 A No one would want to be in the railroad
22 business.

23 Q Could you answer the question, please? Is
24 there ease of access?

25 A Yes.

1 Q Would you explain that?

2 A You can go out and file for imminent domain
3 and get in the railroad business tomorrow if you want to
4 get into it. Nobody wants to get in it because there
5 are no returns in it, sir.

6 Q Do you have any idea of what it takes,
7 particularly in view of your legal background, to file
8 for imminent domain, as you have just put it?

9 A I have done it.

10 Q For what kind of railroad?

11 A Common carrier railroad.

12 Q How many miles?

13 A I was involved in one involving about 80
14 miles.

15 Q That is the maximum?

16 A Yes. Like I say, there is no market to be in
17 the railroad business.

18 Q The basis of your testimony as I understand
19 it, Mr. Fitzgerald, is that you say all the responsive
20 applicants are wrong in saying the consequence of your
21 application if granted would be anticompetitive. Is
22 that a fair statement?

23 A That's right.

24 Q Now, you have got seven other witnesses that
25 you list in your testimony who you rely on, you say, for

1 something. I am not sure what. Is any one of those a
2 policy witness here for our purposes?

3 A I think to some extent Mr. Champion is a
4 policy witness.

5 Q Does he cover the same ground that you cover?

6 A No, I think his focus is more directed toward
7 operating matters.

8 Q Are you relying on Mr. Champion in any way?

9 A I suppose so. All these statements are
10 interrelated.

11 Q Did you intend by your testimony to add
12 anything to the testimony of the other seven witnesses
13 referred to in your testimony?

14 A Yes, I think so. My purpose is to suggest to
15 you that the statements of the other witnesses are, to
16 the extent they tend to be perhaps theoretical, borne
17 out in my experience in the marketplace.

18 MR. NELSON: For clarification -- excuse me,
19 Mr. Auerbach. Were you referring to the seven witnesses
20 listed on Pages 20 and 21 of his testimony?

21 MR. AUERBACH: Yes, sir.

22 MR. NELSON: Because Mr. Fitzgerald does make
23 reference to certain other witnesses, too, and I think
24 there was some confusion there.

25 MR. AUERBACH: Well, I did refer to the seven

1 witnesses.

2 THE WITNESS: I think there are actually eight
3 there if you count them.

4 BY MR. AUERBACH: (Resuming)

5 Q All right, sorry.

6 I take two as one if you put them together in
7 your testimony.

8 Is there someone else besides these eight on
9 whom you are relying?

10 A You mean who is also submitting a verified
11 statement in this proceeding.

12 Q Yes.

13 A No.

14 Q We agreed that the thrust of your testimony is
15 that the responsive applicants are wrong in saying that
16 the consequences of the merger would be
17 anticompetitive.

18 When you use that phrase, "anticompetitive,"
19 do you understand them to be talking about rail
20 anticompetitive or transportation anticompetitive?

21 A As I would use the term it would have to do
22 with first an analysis of the markets, and I think the
23 evidence in this case shows overwhelmingly that because
24 of product and geographic substitution, that the proper
25 focus of the market includes freight transportation

1 generally. That is the primary sense in which I would
2 conclude that it is not an anticompetitive merger.

3 Q Your answer would be, therefore, as I
4 understand it, and correct me if I am wrong, that it is
5 rail anticompetitive, that is, the allegations that it
6 is rail anticompetitive are wrong?

7 A That is right. I would say that it is
8 improper to focus on a mere consideration of whether
9 there is concentration as among railroads, that the
10 proper focus ought to be whether or not there is
11 sufficient fragmentation in the transportation market
12 generally as to cause any anticompetitive consequences,
13 and my conclusion is that it could not.

14 Q Assume for this purpose that you are wrong
15 that there are adverse rail competitive consequences.
16 Should the Commission overcome that result by looking at
17 other transportation modes?

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1 I'm afraid that I can't deal with the subject of
2 competitiveness or anticompetitiveness in the vacuum of
3 rail only, so I have trouble answering your question.

4 Q You've answered the question. You think,
5 therefore, the Commission can take into consideration
6 these other modes in judging whether this merger is to
7 be deemed anticompetitive?

8 A Yes, I think it must.

9 Q Have you read the DOT testimony that was filed
10 on March 21?

11 A No.

12 Q Have you read the DOJ testimony filed on March
13 21?

14 A No.

15 Q Have you discussed that with your counsel?

16 A Yes.

17 Q Have you been told what the testimony purports
18 to allege?

19 A I would say that in total we may have spent
20 five minutes on it, and I have a very superficial
21 understanding of what it says.

22 Q Well, you understand even with that small
23 amount of time spent on it that it alleges that there
24 would be adverse rail consequences from the competition
25 standpoint if the merger is approved?

1 MR. NELSON: For clarification, Mr. Auerbach,
2 when you say "it," do you mean DOT or DOJ or both?

3 MR. AUERBACH: Let me take them separately.

4 BY MR. AUERBACH: (Resuming)

5 Q DOT.

6 A My understanding was not to that effect.

7 Q The same question with respect to DOJ. What
8 is your understanding?

9 A Yes. I understand that the DOJ has a long
10 list, and I'm amazed by it.

11 Q Speaking specifically of anti-rail
12 consequences.

13 A That is my understanding, that they have a
14 long list of claimed competitive problems.

15 Q Have you read the California Department of
16 Transportation statement filed March 21?

17 A No.

18 Q Have you discussed that one?

19 A Yes.

20 Q Do you have any understanding of what that one
21 says about anti-rail competitive consequences?

22 A I understand that they have submitted a
23 laundry list as well.

24 Q Do you consider that those statements of the
25 DOJ and DOT and the California DOT should have

1 consideration with respect to the Santa Fe's general
2 policy considerations in this proceeding?

3 A To the extent that they may be valid, and I
4 think they will down the road.

5 Q How old are you, Mr. Fitzgerald?

6 A Forty-three.

7 Q Now, as I understand it, until 1979 you were
8 performing legal services for Santa Fe.

9 A That's right.

10 Q Then you went to work for the holding company,
11 is that correct?

12 A Yes.

13 Q And you assumed your present position about
14 26, 27 months ago, is that right?

15 A Yes, sir.

16 Q And now you're responsible for all marketing
17 in the combined system of Southern Pacific-Santa Fe or
18 just Santa Fe?

19 A Just Santa Fe.

20 Q That's all marketing, isn't it?

21 A It's all marketing. I have a lot of help.

22 Q I hope so. All traffic questions?

23 A Yes, sir.

24 Q All commercial activity?

25 A They're conducted under my direction.

1 Q Well, is there some that isn't conducted under
2 your direction?

3 A No, sir.

4 Q All industrial development policy?

5 A That's true.

6 Q Did you have any background in any of those
7 areas before 27 months ago?

8 A I suppose.

9 Q Would you explain?

10 A I'm a third generation Santa Fe employee. I
11 grew up on the railroad. The day after I graduated from
12 high school I went to work for the Chicago, Burlington
13 and Quincy Railroad, spent five or six summers in its
14 traffic department, and upon graduation from law school
15 went to work for the Santa Fe and have been involved in
16 a legal capacity with all of the matters that you just
17 discussed from time to time and a number of others. And
18 then in 1979, as you said, went to work for the holding
19 company as an assistant vice president and later as a
20 vice president, and was involved in policymaking and
21 oversight of railroad activities and real estate matters
22 in that position.

23 Q Do you consider yourself familiar with Santa
24 Fe's customers' market practices?

25 A I think so.

1 Q How did you learn that?

2 A Direct contact.

3 Q That would be in this 27-month period or
4 23-month period? I'm sorry. It's 27 months.

5 A Whatever it is. And prior to that.

6 Q You were dealing with Santa Fe's customers
7 prior to that on such things as their marketing needs?

8 A Dealing with them generally with respect to a
9 wide variety of problems that wind up in one fashion or
10 another involved in legal matters.

11 Q Do you think you're an expert on Santa Fe's
12 intermodal competition?

13 A Oh, yes.

14 Q How about their intramodal competition?

15 A Very much so.

16 Q Are you an expert on the nature of the
17 regional economies served by the Santa Fe?

18 A I would say that the state of my knowledge is
19 well above average in that regard.

20 Q Did you acquire that prior to this 27-month
21 period that you've been actively involved as vice
22 president of traffic?

23 A I think it's something that you build on every
24 day.

25 Q Do you know the nature of the regional

1 industries served by the Santa Fe?

2 A I think so.

3 Q Well, how about the Southern Pacific? Do you
4 know the nature of the regional industries served by the
5 Southern Pacific?

6 A Less well, less well.

7 Q How about the regional economies served by the
8 Southern Pacific?

9 A Again, less well but to, I think, a pretty
10 good extent.

11 Q How about Southern Pacific's intramodal
12 competition?

13 A I think I know it pretty well.

14 Q Less well?

15 A Less well.

16 Q How about intermodal competition?

17 A The same.

18 Q Do you think you're familiar with Southern
19 Pacific's customer market practices?

20 A Yes.

21 Q Do you think you know their needs?

22 A Yes.

23 Q Would you tell us now how you acquired that
24 knowledge with respect to market practices and needs?

25 A Well, I'd be happy to try. I have spent the

1. last couple of years in reasonably, I think, intense
2 almost daily contact with not only one customer or two
3 but sometimes a half a dozen or a dozen in a day. That
4 has involved mainly listening, and you learn an awful
5 lot about your competition from just letting a customer
6 tell you how the customer perceives the marketing
7 practice and presence in the marketplace of a competitor.

8 Now, you don't necessarily just take one or
9 two or three customers and what they have to say as
10 being your world view of the subject, but after a couple
11 hundred have told you what they think about what the
12 competition is doing and trying to do and what its
13 presence is in the market and so on, you develop, I
14 think, a reasonably decent composite of what a
15 competitor's strategy is, what a fellow railroad's
16 strategy is, particularly one as the Southern Pacific
17 where there's so many people anxious to tell you about
18 all of the things that are going wrong there.

19 Q So the process you've just described, it's
20 fair to assume, was the way in which you learned
21 Southern Pacific's customer needs and market practices?

22 A I think that's the question I was answering.

23 Q I thought it was, too, but during the middle
24 of your answer I wasn't sure whether the 200 meetings
25 you had were all involved with Southern Pacific. Were

1 they?

2 A Just about every meeting you have with a
3 customer goes through just an entire series of different
4 subjects, generally starting with what your business
5 relationship is with a particular customer, and from
6 there it winds up going through the entire logistics of
7 that particular customer, and inevitably as a part of
8 that the customers want to tell me what they're doing
9 with the Southern Pacific. And, you know, they're very
10 anxious to get this merger over with, and that's the
11 reason they want to tell you about who's a good man,
12 who's a bad man, what we can do to make it better after
13 the merger and so on. It is not just a couple of
14 hundred. I just used that number as something I pulled
15 out of the air. It's probably more like a thousand.

16 Q In 27 months?

17 A Yes, sir.

18 Q Were all these meetings after the merger
19 application was filed?

20 A No.

21 Q Well, didn't they occur after January 1983?

22 A When was the merger application filed -- March
23 of 1984, wasn't it?

24 Q When was it negotiated?

25 A The fall of 1983, summer and fall.

1 Q Do you have any experience in preparation of
2 capital budgets on the Santa Fe?

3 A Yes.

4 Q Is that part of your function?

5 A Now it's not.

6 Q When you decide some particular traffic
7 pattern or rate or route that you're interested in, do
8 you ever get involved with capital budgets?

9 A I may participate in the process to the extent
10 that at this point I might recommend that we purchase
11 some specific equipment to take care of a specific
12 customer need. That would be about the extent of it.

13 Q Wouldn't most equipment purchases emanate from
14 you?

15 A Yes, but there haven't been any.

16 Q But you have done budgets on equipment
17 purchases, as I understand you, is that right?

18 A No. You asked me if I've ever been involved
19 in budgeting at the Santa Fe, and the answer was yes, I
20 used to be involved in the capital budgeting process of
21 the holding company.

22 Q Now, I'm asking you about the equipment
23 purchases. Have you been involved in budgets for
24 equipment purchases?

25 A Since coming to the traffic department?

1 Q Yes.

2 A No. We haven't bought any equipment.

3 Q Before you came to the traffic department did
4 you ever examine or participate in the examination or
5 analysis of the capital budget?

6 A Yes.

7 Q Are you familiar with the phrase DCFROI?

8 A Yes.

9 Q Could you tell us what it means to you?

10 A Discounted cash flow return on investment or
11 something of this sort.

12 Q Fine. Now, can you tell us what the DCFROI
13 rate was in the capital budgets in which you did
14 participate?

15 A They varied.

16 Q Well, give us the spread.

17 A Upwards of 100 percent down to 10 or 12.

18 Q Down to 12 percent?

19 A Or 10.

20 Q Do you think that has any bearing on return on
21 investment?

22 A Sure.

23 Q It implies, in effect, that a decision has
24 been reached to invest some money with return as little
25 as 10 percent then, doesn't it?

1 A And that's done. It's done.

2 Q Do you have any experience with operations?

3 A No. I've been a lawyer to operating people,
4 and I've been involved in the legal end of it but not
5 operations per se.

6 Q Do you have any experience with maintenance of
7 way?

8 A Same answer.

9 Q Maintenance of equipment?

10 A Same answer.

11 Q Do you have any experience with geographic
12 factors that might enter into ratemaking?

13 A Yes.

14 Q Can you illustrate that, please?

15 A Geographic competition, in other words
16 alternate sources for products that would otherwise be
17 shipped on our railroad, impact our ability to charge
18 for our services.

19 Q Might you have different rates depending on
20 geography?

21 A I suppose.

22 Q For the same commodity?

23 A Just about all of our rates are different for
24 the same commodity depending on where it moves, if
25 that's the question you're asking.

1 Q Yes, but can you tell us, can you narrow down
2 how geography enters into that?

3 A I don't understand the question. I'd be happy
4 to try to. Are you talking about topography?

5 Q No. I'm talking about the relationship
6 between geography and competition.

7 A Well, okay. Let me try this and see if this
8 is what you're talking about. Your railroad and ours
9 recently lost a movement of lube oil from Shreveport,
10 Louisiana to the L.A. Basin. The reason we lost it is
11 that Pennzoil worked out an exchange of lube oil with
12 Chevron up in Richmond and decided to truck it down to
13 L.A.

14 Now, that's an example, as I understand it, of
15 how geographic competition for a product causes
16 transportation rates to be either depressed or the
17 transportation movement to go away altogether.

18 Now, is that what you're talking about?

19 Q Yes. Let's continue with that, if you please,
20 Mr. Fitzgerald. Do you consider that the Southern
21 Corridor as a geographic area is unique in ratemaking?

22 A No, I don't concede that.

23 Q Do you concede -- strike "concede" --
24 "conceive" is the word I want. Do you conceive that the
25 Southern Corridor, if it had just one railroad in it,

1 would be able to compete successfully with source
2 competition in the New Orleans area moving to the West
3 Coast?

4 MR. NELSON: I don't understand that
5 question. I don't know if the witness does.

6 JUDGE HOPKINS: Does the witness understand it?

7 THE WITNESS: No.

8 JUDGE HOPKINS: The witness doesn't understand
9 it either, and I don't either.

10 BY MR. AUERBACH: (Resuming)

11 Q How do you define cost of service -- a phrase
12 you have used?

13 A Maybe you could direct me to it.

14 Q Look at pages -- beginning at the bottom of
15 page 11 and 12 and 13, but particularly on the middle of
16 page 12, the last paragraph, total cost of service.

17 A I'm sorry. Just once more. Where is the
18 specific reference?

19 Q You cover the whole subject or a good part of
20 it from the bottom of 11 to 13. The specific phrase
21 appears on the lower part of page 12. If you wait a
22 moment, I'll give you the lines. Seven lines from the
23 bottom of the text before the footnote.

24 A Okay. Well, as I indicate there a line down,
25 with all of the other things that I have said I'm an

1 expert on, I do not profess to be an expert in
2 economics. But my understanding of the total cost of
3 service is that in order to be viable in the long run, a
4 firm must cover its operating costs, generally variable
5 costs, its fixed costs, and it must provide a return on
6 capital, whether that capital be equity or debt. When
7 you add all those together, you have what I would call
8 total cost of service.

9 Q So the three things we add together are
10 operating costs, fixed costs and return on capital, is
11 that correct?

12 A Instead of operating costs I guess probably
13 variable costs would be a little bit more classic.

14 Q Are you familiar with the word or phrase
15 "carry through"?

16 A Yes.

17 Q That is used on the Santa Fe, isn't it?

18 A It's used.

19 Q What does that mean to you?

20 A As it's used on Santa Fe, at least as I would
21 understand it, if you start out with -- well, let me
22 see. Give me just a second. It would be the ratio that
23 is derived if you took net income as the numerator and
24 divided revenues into it. It would be expressed as a
25 percent or a decimal.

1 Q It would not be the same, as you understand
2 it, as net railway operating income, is that correct?

3 A No. Net railway operating income is a
4 number. I'm saying this carry through, as it is
5 expressed by the Santa Fe, generally is a ratio.

6 Q Net railway operating income, under your
7 definition, as I understand it, would represent the
8 amount of money available for fixed costs and return on
9 capital, however, is that correct?

10 A I'm sorry. Could I have that one back?

11 Q Let me restate it. Taking the three factors
12 that you mentioned, which go into the question of cost
13 of service, I asked you whether net railway operating
14 income would cover the first of your three costs, which
15 is variable, and represent the amount available to the
16 carrier for fixed costs and return on capital?

17 A Well, I think net railway operating income is
18 going to be net of both variable and fixed costs, and
19 it's going to represent the residue that's available to
20 satisfy the holders of the equity, because debt is going
21 to be accounted for somewhere there. I have to admit
22 that when you get into railway accounting under the ICC
23 method, I need to look at an income statement before I
24 can discuss the subject intelligently. And if you have
25 one there, I'd be happy to work with you on it.

1 There's net income from railway operations.
2 There's net railway operating income. There's net
3 income. And, you know, the only way to discuss it
4 intelligently is to look at the form.

5 Q When the proposed merger was submitted to the
6 Board of Directors of the Santa Fe, were they advised
7 about costs of service?

8 A I don't have any idea. I wasn't there.

9 Q Do you know whether they were advised about
10 carry through?

11 A I don't know.

12 Q Have you ever read what appears here as
13 KCS-C-1?

14 A No, sir?

15 Q Never seen it?

16 A I have seen it. Mr. Kharasch showed it to me
17 several months ago.

18 Q But you didn't look into it?

19 A No, I didn't.

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1 Q Do you know what the board was told that they
2 could expect to see as a post-merger carry-through?

3 MR. NELSON: Your Honor, I would like to
4 object to this line of questions, because the testimony,
5 the purpose of the testimony here, which was expressed
6 on the first page, is to talk about the policy
7 considerations that lead to conclusions about the
8 trackage rights application.

9 All Mr. Auerbach has been asking about for the
10 last 20 minutes is the initial application and events
11 leading up to it.

12 JUDGE HOPKINS: You have not objected to him
13 doing it, either. I have been waiting for you to object
14 to something as we have gone along, because I think, Mr.
15 Auerbach, you are going into something extensively that
16 is not part of this gentleman's testimony.

17 In fact, I am having difficulty understanding
18 what it is you particularly want from this gentleman.

19 MR. AUERBACH: Well, Your Honor, the witness
20 has testified here that the conditions proposed by
21 applicants should be rejected, and these are policy
22 considerations. If the conditions are to be rejected,
23 we ought to be able to measure against what they think
24 they are going to be able to achieve without conditions
25 that led them to these policy conclusions.

1 JUDGE HOPKINS: Why don't you ask him that
2 question?

3 MR. AUERBACH: Your Honor, I must lay a
4 foundation for it.

5 JUDGE HOPKINS: There has been no objection as
6 you have gone along. If you lay the foundation for half
7 an hour or three-quarters of an hour, we will be here
8 for the rest of the day on just your questioning of this
9 witness.

10 It would be advisable to ask the specific
11 questions and see if there is any objection. If there
12 is any objection, then you have to lay a foundation.
13 Then you will have to go back.

14 MR. AUERBACH: Your Honor, if you will forgive
15 me, I can't ask questions without a foundation in an
16 area as technical as this. He doesn't know what the
17 board was told.

18 I asked him whether he, in terms of his
19 testimony here, has a number in mind for carrythrough.
20 That is what leads to his rejecting the conditions.

21 BY MR. AUERBACH: (Resuming)

22 Q Do you have such a number?

23 A Let me say this, Mr. Auerbach. As I have
24 defined carrythrough, which is, as I say, the way it is
25 used around the Santa Fe, that I am familiar with, I

1 can't deal with the question. If you use another word,
2 maybe we can get down to it.

3 Q Have you heard the number 500 million used at
4 any time as the amount that had to be produced as a
5 carrythrough from this merger?

6 A No.

7 MR. NELSON: I object.

8 JUDGE HOPKINS: He said no.

9 BY MR. AUERBACH: (Resuming)

10 Q What reduction in cost do you see here as part
11 of your testimony for the reason there should be no
12 conditions?

13 A We are anticipating merger savings on the
14 order of 220 million a year, and that has been testified
15 to in the case in chief.

16 Q Now, what does that produce for you by way of
17 a return that would represent the return on capital in
18 the analysis you have given?

19 MR. NELSON: I am going to object to that. The
20 computation is just a mathematical computation. Against
21 what year, Mr. Auerbach? And we will provide the number
22 for you.

23 MR. AUERBACH: Your Honor, the witness has
24 testified --

25 JUDGE HOPKINS: You want the witness to do

1 it. If you can, go ahead. Do you want a specific
2 year? You can do it on that basis.

3 THE WITNESS: I wonder if I could have the
4 question back.

5 JUDGE HOPKINS: Mr. Auerbach?

6 BY MR. AUERBACH: (Resuming)

7 Q You have testified to a cost reduction of 220
8 million.

9 A Yes, sir.

10 Q When the merged company achieves those reduced
11 costs, what will it have in your definition as the
12 return that represents cost of service?

13 A All right. Let me try to work through this
14 for you. In order to understand what the \$220 million
15 is going to mean, you have to start out with where you
16 are, where the two railroads are on a separate
17 stand-alone basis.

18 In the case of the Southern Pacific that is
19 not a very good place on an historic RRB accounting
20 method, the Southern Pacific lost \$139.8 million last
21 year. Santa Fe on that same basis made \$87.9 million,
22 for a total aggregate of minus \$51.8 million.

23 If you were to apply the \$220 million to that
24 it would get you into the area of \$170 million in net
25 income on the RRB basis. But that is only one thing to

1 look at. You need to look at cash flows. You need to
2 look at a lot of things.

3 Q In order to determine total cost of service?

4 A The total cost of service ---

5 MR. NELSON: Do you use the phrase as Mr.
6 Fitzgerald does in the economic sense on Page 12 of his
7 testimony, for clarification purposes, Mr. Auerbach?

8 MR. AUERBACH: Yes, sir.

9 THE WITNESS: When we are all said and done,
10 assuming the number that I just gave you, we are not
11 going to cover the total cost of service in that we are
12 not going to be able to achieve a market rate for the
13 equity in the two companies. We are presumably going to
14 be able to carry -- to cover our variable and our fixed
15 costs.

16 BY MR. AUERBACH: (Resuming)

17 Q You said there are other factors, Mr.
18 Fitzgerald, in addition to that net income on the
19 combined basis, and that gets into cash flow, and I
20 questioned you on cash flow, and then you have gone back
21 to just net income. Are there any other factors?

22 A Well, you asked another question.

23 Q Are there any other factors besides net
24 income?

25 A Sure, cash flow is one.

1 Q Do you consider cash flow a part of total cost
2 of capital?

3 A No, no, no, no.

4 Q Sorry. Total cost of service. I beg your
5 pardon.

6 A No. I was addressing the question of what are
7 the things that are going to be important that we are
8 going to look into in terms of whether to proceed with
9 the merger, and cash flow is an important
10 consideration.

11 Q I would like to stay, if you don't mind, with
12 total cost of service. What factors enter into that
13 beyond the three that you gave us? There are operating
14 costs, fixed costs, and return on capital, variable
15 costs, fixed costs, and return on capital.

16 A We can stick with those.

17 Q All right. Now, if you had, after your
18 reduction in cost, if you had only minus \$51.8 million
19 of net income, what kind of return on capital are you
20 going to get from the third leg of your cost of
21 service?

22 MR. NELSON: The question misstates Mr.
23 Fitzgerald's computation which he went through for Mr.
24 Auerbach's benefit. There would be a net \$170 million
25 plus after the combination.

1 BY MR. AUERBACH: (Resuming)

2 Q Now, take that \$170 million and tell us the
3 rate of return you would have.

4 A Well, if you assume that -- I need to look at
5 some financial stuff. Does someone have an annual
6 report?

7 MR. NELSON: Mr. Auerbach, do you happen to
8 know the combined net asset base of the companies? That
9 is a necessary step in this computation. We don't have
10 it handy.

11 MR. MARTIN: I could help to this extent. Mr.
12 Koehn indicated on Page 76 of his statement that the
13 Santa Fe's net investment on a book basis in 1983 was
14 \$3.8 billion, just the one railroad.

15 MR. AUERBACH: There has been in Mr.
16 Fitzgerald's testimony some reference to return, so
17 presumably you would have some idea of the pro forma
18 return, I assume.

19 THE WITNESS: Well, it is going to be 2 or 3
20 percent. When you consider that the current cost of
21 capital is, according to the ICC, 11 percent on a real
22 basis, I can assure you that it is not going to
23 approach that number.

24 BY MR. AUERBACH: (Resuming)

25 Q So you are going to fall short on your own

1 test of what you hope to achieve if this merger is
2 permitted to go through, aren't you?

3 A Absolutely.

4 Q Now, what does that mean you would have to do
5 in order to make that shortfall up?

6 A Well, there are only two things you can do.
7 You can raise prices or you can reduce costs or you can
8 continue to wither.

9 Q Do you think that you have already reduced
10 costs as much as you can in the estimate of the \$220
11 million that you have used here?

12 A I don't know. It is just an estimate. I hope
13 we can do better.

14 Q Well, do you have any feel for how much more
15 you might be able to do?

16 A No.

17 Q Mr. Fitzgerald, I am just getting to the
18 question of how much of a shortfall there is.

19 A Yes, sir, and I am trying to tell you I don't
20 know. I hope we can do better.

21 Q All right. Could you tell us percentagewise
22 how much you would have to raise rates to get up to the
23 11 percent number you have just used as a return?

24 A I have not done that computation, because it
25 would have been pure folly, but I did read Mr. Koehn and

1 Stangle's summary of what Santa Fe would have to do in
2 order to be revenue adequate, and I think it is on Page
3 76 of their statement.

4 They say that we would have to raise rates 30
5 percent. As you can well imagine, we are now in the
6 area of sheer theory.

7 Q Would you assume that they meant across the
8 board? Do you have any feel for that?

9 A They did mean across the board. They meant
10 that the revenue would have to increase 30 percent.

11 Q But now referring back to prior testimony it
12 couldn't be a rate increase across the board, could it?

13 A Well, it couldn't be a rate increase anyhow,
14 period. I am just saying, the question was, what will
15 you need in order to be revenue adequate, and the answer
16 is, a 30 percent increase in revenues.

17 Now, are you asking me, can we get it? The
18 answer to that is no, we can't get any of it. We are
19 already getting everything we can get.

20 Q Now, as you indicated earlier, that would
21 depend upon the investment base you used, wouldn't it?

22 A Sure.

23 Q You have to measure the 30 percent against
24 something.

25 A Yes.

1 Q What is the investment base?

2 A Well, ours is \$3.8 billion, and the Southern
3 Pacific's is probably a similar number.

4 Q That is based upon book figures?

5 A Sure.

6 Q Do you have any idea what the aggregate market
7 value of your stock is?

8 A Our stock is 100 percent owned by Santa Fe
9 Southern Pacific Company. What is a stock worth when it
10 is wholly owned by a parent? I couldn't guess.

11 Q Do you have an idea? Do you know the number?

12 A I don't think the number exists.

13 Q Do you know the number for Santa Fe Southern
14 Pacific Holding Company?

15 A The market value of its shares? I could
16 figure it out if you tell me what it closed at
17 yesterday. We have about 185 million shares
18 outstanding, and the last time I looked it was about
19 \$26.

20 If you would like me to do the math, I will.

21 Q You would agree with me that is less than \$5
22 billion, wouldn't you?

23 MR. NELSON: Your Honor, I want to object to
24 this line of questioning. I don't want to keep
25 interrupting, of course, but I don't know what this is

1 laying a predicate for.

2 JUDGE HOPKINS: Why don't you say for purposes
3 of the question? Why don't you do it that way?

4 MR. AUERBACH: To multiply 18 by 26 obviously
5 is under 50.

6 THE WITNESS: Well, I am a little slow this
7 morning.

8 BY MR. AUERBACH: (Resuming)

9 Q Assume it is under 5 billion, Mr. Fitzgerald.

10 A It looks like about 4.8 billion and change.

11 Q Would you regard that as a proper basis for
12 computing return?

13 MR. NELSON: For the railroad alone, or for
14 the balance of the assets that --

15 MR. AUERBACH: All railroad assets, obviously,
16 because that is the market value of all the assets.

17 MR. NELSON: I object to the form of the
18 question and the underlying hypothesis, because the 4.8
19 billion and change represents a hell of a lot more than
20 railroad assets.

21 JUDGE HOPKINS: Strike the "hell."

22 MR. NELSON: I am sorry.

23 THE WITNESS: The purest test of what anything
24 is worth is what a willing buyer and a willing seller
25 are willing to pay for it.

1 BY MR. AUERBACH: (Resuming)

2 Q So we know now it is something less than \$4.8
3 billion for the railroads, don't we?

4 A I don't know that.

5 Q You have just heard your counsel say they are
6 the assets. It is something less than \$4.8 billion,
7 isn't it?

8 A That is what the market seems to value it at,
9 I suppose.

10 Q You have just given us a definition of an
11 efficient market, haven't you?

12 A Yes, sir.

13 MR. NELSON: Excuse me, Mr. Fitzgerald. I
14 want to object to this whole line of questioning.

15 It is so far beyond the scope of anything that
16 appears in his statement, and it is pure argument
17 besides at this stage of the game.

18 JUDGE HOPKINS: We are getting into argument,
19 Mr. Auerbach. Let's get into questions.

20 MR. AUERBACH: Yes, I regret that we got into
21 arguments.

22 JUDGE HOPKINS: Thank you.

23 BY MR. AUERBACH: (Resuming)

24 Q Mr. Fitzgerald, do you think the market value
25 of the rail properties as we have limited it would be a

1 fair test for determining the return on capital portion
2 of your three factors?

3 A No, I think you are going about it backwards.
4 I think that the reason that the market values these
5 railroad stocks as lowly as they do notwithstanding the
6 investment in the companies is that the market
7 recognizes that these carriers are revenue inadequate,
8 that they are making 3 percent on investment. That is
9 not a very attractive place to put your money.

10 Q Do you know whether the market capitalization
11 rate of your earnings is higher than, say, what it is
12 for the Burlington Northern?

13 A I don't know.

14 Q Do you know whether it is higher for your
15 railroad than it is for CSX?

16 A I don't know.

17 Q How about Norfolk and Southern?

18 A I don't know. I haven't thought about it.

19 Q As I understood your testimony, and correct me
20 if I am wrong, revenue adequacy is the real goal of the
21 merger. Is that right?

22 A No, I think it is an ideal against which
23 market concentration should be tested, and what I am
24 saying is that revenue adequacy is not going to result
25 from this merger, but that at least we may wind up with

1 a company after the merger that has somewhat higher
2 likelihood of being able to stay in business for the
3 longer term.

4 Q Do you define revenue adequacy as synonymous
5 with cost of service?

6 A Well, they are certainly related.

7 Q Does that complete your answer?

8 A Well, if you are able to cover your full cost
9 of service, you would be revenue adequate.

10 Q I think you have recognized there is no Class
11 1 railroad in the country then that is revenue
12 adequate.

13 A That is right.

14 Q To carry your concept through, what if all the
15 railroads in the country were combined into one
16 carrier? Do you think there would be revenue adequacy?

17 MR. NELSON: I object to that, Your Honor.

18 This is really --

19 JUDGE HOPKINS: It is an interesting
20 question. Let him go ahead and answer.

21 Go ahead.

22 THE WITNESS: And the rest of the competition
23 from other modes stayed as is?

24 BY MR. AUERBACH: (Resuming)

25 Q However you wish to define it.

1 A Well, let's define it that way, that the rest
2 of the competition stayed as is and we had one rail
3 system in the country. I have very serious doubts as to
4 whether it could be revenue adequate.

5 Q It is a fair conclusion, isn't it, Mr.
6 Fitzgerald, that efficiencies alone will not produce
7 revenue adequacy?

8 A Well, I don't agree with that. I think that
9 if we could get our railway labor situation under better
10 control than we have it now, and get those efficiencies
11 that we are talking about in this merger, that we could
12 approach revenue adequacy. I think that is the other
13 big issue that confronts our industry.

14 Q I asked you earlier whether you had heard the
15 number 500 million used, and you had not.

16 A No, sir.

17 Q Do you believe that if 500 million were
18 achieved as a consequence of the merger there would be
19 revenue adequacy?

20 A Well, just on the basis of the numbers that I
21 looked at this morning, 500 million would not make the
22 merged company revenue adequate.

23 Q So you would still have the problem, wouldn't
24 you, as you aimed toward revenue adequacy, of raising
25 rates?

1 A I am sorry. Let me have the question back. I
2 am not sure of your verb.

3 Q I say, so you would still have the problem as
4 you aimed toward achieving revenue adequacy of having to
5 raise rates.

6 A You will always try to raise rates where the
7 competitive atmosphere would permit it.

8 Q Does that depend on market power?

9 A Sure. It depends if you have it or not.

10 Q You testified that you have substantial market
11 power today, haven't you?

12 MR. NELSON: Where is that, for
13 clarification?

14 BY MR. AUERBACH: (Resuming)

15 Q Page 5, eighth line.

16 MR. NELSON: I think you misconstrued that
17 passage, counsel.

18 THE WITNESS: I think if you read that in
19 context, what I am saying is that if we buy the theory
20 that some of the economic witnesses for the responsive
21 applicants would have you buy, we would have substantial
22 market power and we would not be revenue inadequate
23 because we could substantially raise our rates.

24 The point that I am making is that this kind
25 of a tunnel vision compartmentalization artificially of

1 transportation market is unreasonable.

2 BY MR. AUERBACH: (Resuming)

3 Q Isn't it competition that prevents you from
4 having that kind of substantial market power referred
5 to?

6 A Absolutely. Absolutely.

7 Q And without competition, what would be the
8 result?

9 A We could raise your rates.

10 Q That would be an exercise of market power,
11 wouldn't it?

12 A That is right. What I am saying here is that
13 there is no market power, because obviously we haven't
14 been able to raise our rates.

15 Q What I understood you to say was, if the
16 merger is approved without conditions, you will have
17 market power.

18 A I don't remember saying that, counsel.

19 Q I am asking you the question. Isn't that what
20 you just said?

21 A No.

22 Q All right. Will you?

23 A No.

24 Q You will not have market power if you are the
25 only railroad in the southern corridor?

1 MR. NELSON: Asked and answered.

2 JUDGE HOPKINS: He has answered this
3 question. He has been talking about other competition,
4 as I understand it, too, besides rail competition.

5 BY MR. AUERBACH: (Resuming)

6 Q I am not asking you -- on rail competition --
7 if you have answered it, all right, but I didn't
8 understand it to be answered -- if you are the only
9 railroad after merger without conditions, will you have
10 market power in the southern corridor?

11 A No. Let me put it this way. We will not have
12 enhanced market power. We will have the market power we
13 have now, which as I am defining market power, it is the
14 ability to charge something above variable costs.
15 Nothing like you might charge in the sense of monopoly
16 power.

17 What I am saying is, we would have little or
18 no enhanced market power as a result of being the only
19 railroad, as you call it, in the southern corridor, for
20 the simple reason that there is a plethora of
21 competition from other modes.

22 Thank you, Mr. Kharasch.

23 Q You have told the Commission here in your
24 testimony that there is no serious risk that you would
25 have monopoly profits. Is that right?

1 MR. NELSON: Could we have a page reference,
2 Mr. Auerbach?

3 MR. AUERBACH: Yes, you can, though I thought
4 the witness knew his own testimony.

5 THE WITNESS: My counsel doesn't know it.

6 JUDGE HOPKINS: Do you know it? If you know
7 where it is he is referring to, then we can go on
8 without him having to find it.

9 MR. NELSON: Neither one of us has had a
10 chance to look at it much this morning.

11 JUDGE HOPKINS: Mr. Auerbach, can you help
12 them?

13 MR. AUERBACH: My recollection is that it is
14 at around 14 or 15, but I would have to find it now,
15 sir.

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1 THE WITNESS: Page 14?

2 BY MR. AUERBACH: (Resuming)

3 Q Do you see it on 14?

4 A Yes, at the bottom of that full paragraph.

5 Q I am referring to the words "serious risk"
6 somewhere.

7 A That is down at the bottom of 14.

8 Q Yes, that is right. Sorry. Yes, that is
9 where it comes from.

10 A Could you restate it?

11 Q Referring to that use of words at the bottom
12 of 14, does that imply there is some risk?

13 A No, it is not intended to imply there is any
14 risk at all.

15 Q You actually mean there is no risk of monopoly
16 profits?

17 A Exactly.

18 Q Is that consistent with what you said at an
19 earlier point and the appreciable amount of market
20 power, looking at the middle paragraph on 14?

21 A Well, let me put the two parts together for
22 you. As I have said, when I speak of market power I
23 speak of the ability to charge more than variable cost.
24 In other words, to get some of the fixed costs into the
25 rate.

1 Now, covering your variable and fixed costs
2 does not get you in a position of being a monopolist,
3 because the next layer of cost, as we discussed, is the
4 cost of capital, and before you reach the position to
5 charge monopoly type rates and get monopoly type
6 profits, you have to build in the three building blocks:
7 building block number one, the variable cost; number
8 two, the fixed cost; number three, the cost of capital.

9 And what I am talking about when I talk about
10 market power is above the variable cost level into the
11 fixed rate level and into the cost of capital level, and
12 what I am saying is that there will be little or no
13 increase in market power, and even if there is some
14 small increase in market power, it certainly isn't going
15 to carry us to the level where we are able to cover both
16 our fixed costs and our cost of capital.

17 Q But referring to the question of monopoly,
18 there is no risk of monopoly, as you have testified.
19 There is some risk as you see it of use of market
20 power?

21 A Well, as I testify here, I am unaware of any
22 place where there is such a risk of even a small
23 increase of market power, a small increase in rates.
24 What I am saying here from a theoretical point of view
25 and trying to, you know, walk through the economics of it

1 is that even if there were some small increase in market
2 power, some small increase in rates, that that is not
3 indicative of our ability to act as a monopolist. On
4 the contrary.

5 Q But when you say there is no risk of monopoly,
6 you give two reasons, don't you, on Page 15 and over on
7 Page 16? Those are your two reasons, aren't they?

8 A They are reasons. I think that the statement
9 is replete with reasons why we are not going to be able
10 to act as a monopolist.

11 Q But look at the one on 16, the one you call
12 second. That is, as I understand it, and correct me if
13 I am wrong, what you are saying here is the consequences
14 of the Commission imposing adverse conditions on the
15 merger are more serious than the consequences that you
16 are wrong in saying there is no risk of monopoly.

17 A Yes. Well, no. Let me change my mind and
18 answer the question after you asked the last word. What
19 I am saying is that there is a greater danger to the
20 public good of disapproving the merger and having these
21 two railroads orphaned in the west and presumably have
22 the Southern Pacific at the Bankruptcy Court in short
23 order than there is in approving the merger and then
24 with the power to regulate that the Commission has being
25 in a position to supervise anything that could turn out

1 to be interpreted as anticompetitive behavior.

2 I am so convinced that that is an
3 impossibility that I am willing to concede that the
4 Commission ought to come in and monitor that very
5 closely if it chooses to.

6 Q Is it a fair summary of what you just said
7 that it is a better risk from the public standpoint to
8 have a monopoly than to turn down the merger?

9 A No, that is not a fair statement. I am saying
10 there is no possibility there is going to be a monopoly,
11 but if there is any risk at all, it is attendant in
12 going ahead and approving the merger, that, for example,
13 some rates might rise somewhere, that the Commission has
14 plenary authority to manage that, to regulate it, and
15 that that is a far better risk to run than having a
16 bankruptcy in the west.

17 Q You used the phrase "if conditions are imposed
18 which amount to disapproval" at the top of Page 16,
19 second and third lines.

20 What do you mean by that?

21 A I mean that Santa Fe Southern Pacific top
22 management has taken the view -- it has been expressed
23 here in this proceeding, and let me assure you it is not
24 intended as a threat but only as a statement of fact,
25 that if the conditions to this merger are so onerous

1 that upon analysis the holding company concludes that it
2 cannot go forward with the merger because of the
3 conditions, that it will not, and in such a case the
4 conditions, if they were sufficiently onerous, would
5 amount to disapproval.

6 Q You are not able, are you, to tell us what
7 onerous means in that context?

8 A As I testified earlier, you have to start to
9 determine which straw is going to break the camel's back
10 with reference to where you are right now, and what I am
11 here to tell you is that these two railroads are not in
12 robust health.

13 Q In giving these reasons, and I will accept
14 your answer that there are more than the two factors
15 that we referred to on Page 15 and 16, one of them is
16 the fact that you concurred and supported the NITLAR
17 agreement. Is that correct?

18 A Yes.

19 Q Did you participate in the negotiation of
20 that?

21 A Yes.

22 Q Then is it reasonable to assume that you know
23 what the language means?

24 A Well, it is reasonable to assume I know as
25 much about what it means as any other participant in the

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1 proceeding.

2 Q Did you recommend adoption of the agreement to
3 your superiors at Santa Fe?

4 A I did, and also to the AAR, yes.

5 Q When you did that, did you explain some of the
6 words used in the agreement?

7 A I tried.

8 Q As I understand it, there are three criteria
9 that are set forth in the agreement which are to be
10 applied by the ICC in determining whether to suspend
11 from investigation any proposed route or rate change.
12 Is that correct?

13 A Let me get it. You are referring to Section
14 3.

15 Q I don't have it in front of me.

16 A Section 3 says that the ICC shall suspend for
17 investigation the proposed cancellation of a through
18 route and/or a joint rate if it determines, and then
19 there are three subsections.

20 Q Let's take the first of those three
21 subsections. That one relates to shippers, doesn't it?

22 A The protesting shipper is utilized or would
23 utilize the through route or rate, yes.

24 Q And the criteria to be applied is that the
25 protesting shipper says that he would utilize the rate

1 or route, joint rate to meet a significant portion of
2 requirements.

3 A That is right.

4 Q What does the word "significant" mean there?

5 A That is going to be left to the judgment of
6 the ICC assuming that it concurs in this as part of its
7 current rulemaking.

8 Q Did you tell your principals what you thought
9 the word meant when you used it?

10 A I told them I thought that just about every
11 change in the status quo would be suspended as a result
12 of this.

13 Q Look at the second criterion.

14 A That a protesting carrier is utilizing or
15 would utilize the affected through route or joint rate
16 for a significant amount of traffic.

17 Q Now we are talking about carriers, aren't we?

18 A Yes.

19 Q And again the phrase "significant amount" is
20 used. How is it used in that one?

21 A Again, perhaps I was a little bit summary in
22 my report to Santa Fe management, but my conclusion is
23 that almost any change in the status quo would be
24 suspended.

25 Q The third criterion, that the cancellation

1 would eliminate effective railroad competition for the
2 affected traffic, now, that is in terms of competition
3 as competition, rather than in terms of a protesting
4 shipper or a protesting carrier, isn't it?

5 A Yes.

6 Q How would that be carried out?

7 A Again, it is hard for me to imagine that
8 either A or B wouldn't apply in almost any proposed
9 cancellation. So I didn't even trouble myself with C.

10 Q That is, the question of effective railroad
11 competition doesn't get to be a real thing. Is that
12 what you are saying?

13 A I am saying that any change is going to be
14 suspended as I read this. We assume that at least.

15 Q This speaks of effective traffic between
16 origin and destination. Would that have any bearing on
17 your answer?

18 A No. Any change in the status quo, as I read
19 this, is likely to be suspended.

20 Q Can you give us any help in terms of the kind
21 of situation that would come up under C and not come up
22 under A or B?

23 A No.

24 JUDGE HOPKINS: Mr. Auerbach, I think this
25 might be a good time for a recess. Let's take 15

1 minutes.

2 (Whereupon, a brief recess was taken.)

3 JUDGE HOPKINS: Let's get back on the record.

4 Mr. Auerbach.

5 MR. AUERBACH: Thank you, sir.

6 BY MR. AUERBACH: (Resuming)

7 Q In your testimony you address the conditions
8 that have been proposed by the responsive applicants and
9 speak of broad flaws or major flaws in them, and you
10 define your approach to it, as I understand it, on the
11 basis that some of them deal with vertical effects and
12 some of them deal with horizontal effects.

13 A Yes.

14 Q Would you agree that your definition of
15 vertical consequences only includes route closings, rate
16 cancellations, and discriminatory or inefficient traffic
17 diversions?

18 A Yes. As I reflect on my statement, as I have
19 done in the last few days, if I made a mistake in its
20 construct, it was in perhaps trying to tailor it a
21 little bit too much to the point of view of an economist
22 and perhaps not quite enough to a guy who does what I
23 do.

24 But as I tried to draw together the
25 distinction between vertical and horizontal, vertical

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1 does deal with the subject you just mentioned, but the
2 way I sort of saw it, it generally dealt with the
3 subject of a railroad trying to make joint line
4 operation difficult or impossible.

5 And therefore the primary organization that
6 would be harmed in that sense would be the connecting
7 railroad as opposed to the shipping public.

8 As I looked at horizontal, I looked at it as
9 dealing more with a reduction in competitive options in
10 a parallel sort of a setting, and there presumably if
11 there were such harm it would fall on the shipping
12 public directly.

13 Q Is it fair to say that you are trying to
14 distinguish between vertical and horizontal as you now
15 view them, that horizontal is essentially confined to
16 reductions in or elimination of competition in
17 particular marketplaces?

18 A I don't know that I view them any differently
19 now than when I prepared this statement. So let me
20 concern myself just a moment with the preamble. All I
21 am trying to do is to try to take what is essentially
22 economics and try to bring it down to marketing and
23 sales.

24 But dealing then with horizontal as I would
25 understand horizontal in the transportation context, it

1 would refer to eliminating a player in a market, yes.

2 Q Let's look at KCS and its responsive
3 application here. Would you regard the trackage rights
4 being sought by KCS as falling under your vertical
5 definition or your horizontal definition?

6 A Well, I would understand -- I am sorry. I
7 thought I knew what you were asking. Maybe I don't.
8 Are you talking now about the independent ratemaking
9 authority?

10 Q No, just the trackage rights.

11 A Just the trackage rights.

12 MR. NELSON: For clarification, Mr. Auerbach,
13 which particular ones? There are three segments.

14 MR. AUERBACH: All trackage rights. If the
15 witness thinks they don't fall into that, fine.

16 THE WITNESS: Well, let's take New Orleans and
17 Lake Charles first. I would consider any problem there
18 to be -- let me stop and just say that I don't concede
19 that there are problems, but if we want to categorize
20 these by vertical as against horizontal, New Orleans to
21 Lake Charles would have to be a vertical question,
22 because there is not a Santa Fe Southern Pacific side by
23 side operation as between those points.

24 You asked for Beaumont to Houston and the
25 answer to that would be the same. That would also be a

1 vertical kind of context as I would understand it.
2 Houston to Texas City, Galveston could have horizontal
3 aspects to it, and Greenville to Fort Worth I would have
4 to consider vertical.

5 BY MR. AUERBACH: (Resuming)

6 Q Would you consider all of the so-called IRMA
7 conditions which are sought by KCS to be horizontal?

8 A Yes.

9 Q In that kind of condition, there is no adverse
10 impact on the merged companies' reduction in cost, is
11 there?

12 A Oh, gee, I sure think so. And if you haven't
13 done so, I recommend you read Mr. Simpson on the
14 subject, Mr. Owen, Mr. McInnes, Mr. Lynch, and Mr.
15 Kelly, all of whom deal with some very substantial costs
16 of such an operation.

17 Q Do you have any independent view, or are you
18 just relying on those people to whom you have referred?

19 A I have read their statements, and they wash
20 with me.

21 Q You don't have any independent view apart from
22 those statements?

23 A I don't have an independent view at all. I
24 believe what they are saying.

25 Q When you speak of reduction in costs, you also

1 include in that the possibility that there might be
2 increases of cost apart from the reductions that you
3 have outlined in your proposed merger savings?

4 A Might there be increases in costs to the
5 merged railroad?

6 Q Let me clarify. Does reduction in costs as
7 used by the applicants here represent in any way the
8 increased costs that the witnesses you have talked about
9 attributed to the IMRA?

10 A The cost efficiencies that we are attempting
11 to bring into being through this merger are gross in the
12 sense that they are not netted against any additional
13 costs that would be the result of IRMA either in terms
14 of traffic diversions to the KCS or in terms of the
15 additional costs of operation under IRMA.

16 So, in order to find out where we would stand
17 post-merger, we would need to calculate all of those
18 additional costs and net them against the gross savings
19 that we anticipate.

20 -Q * Have you done that?

21 A No, we haven't. You know, we have captured,
22 obviously, elements of the increased costs, but we
23 haven't put together a comprehensive analysis, and the
24 reason we haven't is, as you can tell, you and the other
25 carriers are seeking rights all over the map. It would

1 just be an impossible thing. We have thought about it.

2 Q If the IRMA were made effective, would it
3 change your method of operations in any way?

4 A Well, now you really are out of my bailiwick.
5 As you know, I am not an operations man. But obviously
6 it would affect them, and I recommend you ask Mr.
7 Simpson how.

8 Q You have no independent view on that?

9 A No, sir.

10 Q With respect to the IRMA in its entirety, do
11 you have any independent views beyond what you have said
12 at the bottom of Page 19, top of Page 20?

13 A Let me give you an emotional answer first. I
14 think it is ridiculous.

15 Q Now, how about a railroad answer?

16 A Even a railroad answer. It just tends to
17 violate my basic sense of what is right and decent.

18 Q But it is also true, isn't it, that you don't
19 refer to it except at the bottom of Page 19 and top of
20 20?

21 A Well, I refer to it throughout this statement,
22 you know, which deals generally with the entire subject
23 of trackage rights and the IRMA and talk in what I
24 consider to be rather straightforward terms about why
25 none of these conditions is needed.

1 Q When you define the IRMA as being horizontal
2 in its entirety and adverting to the definition of
3 horizontal that we agreed upon, what markets do you
4 consider are affected?

5 A Well, again, not conceding that there is any
6 problem in any markets, the IRMA appears to want to
7 reach any place where there two railroads and would be
8 one, regardless of whether the KCS is now or was ever
9 involved in any of those markets.

10 Q Is it fair to say that you think you could be
11 comfortable with the IRMA if it were limited to specific
12 commodities?

13 A I certainly think that. At the very minimum,
14 for anything to have any surgical effect, which is the
15 subject I am dealing with here on the bottom of 19 and
16 the top of 20, you should not construct any sort of
17 ratemaking authority to deal with commodities in
18 geographic areas where it can be demonstrated that there
19 is no proble.

20 Q Even if there were no demonstration of
21 problem, it would act as a competitive tool for the
22 shipper, wouldn't it?

23 A Sure. Shippers love options, as I have
24 said.

25 Q When you speak of commodities, do you have any

1 particular commodities in mind?

2 A Well, the only purpose in writing this the way
3 I did is that Mr. Levin's statement and his cross
4 examination both suggested there was no competitive
5 problem with fresh produce, and yet KCS's IMRA would not
6 restrict produce as a commodity.

7 And the only purpose in saying this as I did
8 is to suggest that KCS apparently hasn't paid any
9 attention to the fact of whether there is a competitive
10 problem or not in structuring the IRMA.

11 Q From this reference to fresh produce, you make
12 a generalization of commodities without any further
13 specification. Is that right?

14 A I am saying I think the burden is on the KCS
15 to tailor a condition to meet the problem that it sees,
16 and it has not done that.

17 Q All my question goes to, Mr. Fitzgerald, is
18 whether you did think of any specific commodities beyond
19 the fresh produce.

20 A Yes, I have thought of lots of them that
21 aren't involved.

22 Q Could you tell us?

23 A Any TOFC.

24 Q Any TOFC?

25 A Yes, sir.

1 Q Any problems apart from TOFC?

2 A Sure, all kinds of carload problems.

3 Q All right. Go ahead.

4 A I think that covers the universe.

5 Q Did you discuss any kind of commodity
6 limitation on IRMA with any state or federal government
7 department?

8 A I did not.

9 Q Do you know whether anybody did?

10 A I don't know.

11 Q Referring to the trackage rights which you
12 have characterized as both horizontal and vertical, and
13 I am speaking of KCS only, that is just a question of
14 payment, isn't it?

15 A That is right.

16 Q Do you think that the question of payment
17 should be in any sense cognizant of the circumstances
18 under which the trackage rights arise?

19 A Well, let's go back to your last question. My
20 focus there was the bottom of Page 21. I have spent the
21 20 preceding pages talking about why trackage rights in
22 my judgment are not justified, that is to say, the
23 imposition of trackage rights by this Commission is not
24 justified.

25 On the bottom of Page 21, I concede that there

1 is no particular problem with a voluntary trackage
2 rights authority freely negotiated by the parties at
3 arm's length and so on. Now, in that context, I gave
4 the answer to the preceding question, which was, it is
5 simply a question of payment.

6 Q My followup question goes to the situation
7 where two carriers proposed to merge, and under those
8 circumstances, is the question of trackage rights
9 something more than mere payment?

10 A The Commission has authority to grant
11 trackage rights. As part of that, I would say that the
12 Commission has the authority to determine the form, the
13 nature, and the amount of the payment. And the
14 applicants to the proceeding have the right to either
15 accept those terms or not to merge.

16 Q As far as you have expressed economic opinions
17 here, do you consider the fact of merger as having any
18 bearing upon the determination of price for trackage
19 rights?

20 A If the Commission were to determine the
21 trackage rights were to be granted, which, needless to
22 say, I would disagree with, the Commission's past
23 practice has been to encourage that trackage rights,
24 once granted, are exercised.

25 The way that the Commission has done that

1 historically has been to grant the trackage rights at
2 bargain basement prices. Now, why does the Commission
3 do that? Because it intends to subsidize a competitive
4 rail option at the expense of the merged carrier.

5 Q For the benefit of the shipper, would you
6 say?

7 A I wouldn't say that, no.

8 Q For the benefit of the other carrier, would
9 you say?

10 A Yes. Now we are getting closer to it.

11 MR. AUERBACH: I have no other questions, Your
12 Honor.

13 JUDGE HOPKINS: Who is going to be next?

14 BY MR. LIVINGSTON:

15 Q Mr. Fitzgerald, my name is Bill Livingston. I
16 am here for Union Pacific.

17 A Good morning.

18 Q Since the establishment of the voting trust,
19 have Santa Fe and Southern Pacific competed vigorously?

20 A Yes.

21 Q And by that question I mean competed
22 vigorously with each other.

23 A Competed vigorously with all of their
24 competition, to my knowledge.

25 Q Right now I just want to focus on the

1 competition between the two companies.

2 A Okay.

3 Q Have the two companies competed vigorously
4 against each other since the establishment of the voting
5 trust?

6 A Where competition existed prior to the voting
7 trust, the voting trust didn't change anything. It
8 continued to do business as usual.

9 Q Have you instructed your people in the traffic
10 department at Santa Fe to treat Southern Pacific as a
11 competitor and to compete just as vigorously against
12 them as you do against anyone else?

13 A Yes. Nothing has changed.

14 Q Do you keep tabs on Southern Pacific's
15 marketing moves, its advertising, its pricing changes?

16 A I don't know that we do that any differently
17 than we do with any other competitors. In fact, I would
18 say we don't but we generally try to keep abreast of
19 what all the other players in a given market are doing.

20 Q I am not asking about all the other players.
21 I am asking about Southern Pacific. Do you try to keep
22 track of what they are --

23 A The only thing I am trying to tell you, Mr.
24 Livingston, is that we don't single them out for any
25 special treatment one way or another, and as we approach

1 a particular piece of business, we have to approach it
2 keeping in mind all the people that are interested in
3 handling it. Not simply one of the choices.

4 Q You do keep tabs on Southern Pacific's pricing
5 moves, for instance, in major corridors, do you not?

6 A We try, where we are also involved in those
7 areas.

8 Q Are you familiar with an article that ran in
9 Fortune Magazine, January 21, 1985, issue?

10 A Yes.

11 Q That dealt with Southern Pacific-Santa Fe?

12 A Yes, I am.

13 Q I see that you have a copy of the article with
14 you. I take it you have read this when it was
15 published.

16 A I did. I did read it.

17 Q It says in the very top that Santa Fe and
18 Southern Pacific are still competing fiercely against
19 themselves. Is that fierce competition limited to
20 certain commodities, or do you compete with them across
21 the board in the business of transporting freight in
22 those territories where you have parallel lines?

23 A I think we compete with them and with others
24 every place we go, and where they go and we go, we
25 compete with each other notwithstanding what the

1 commodity is or anything of the sort.

2 Q It says in this article, on the first page of
3 the article, that in the past year, which I take to be a
4 reference to 1984, and now I am quoting, "Southern
5 Pacific has managed to steal some of Santa Fe's
6 piggyback freight business."

7 Was that, the piggyback business referred to
8 in the article, did that include piggyback business that
9 moves on the southern corridor between California and
10 the southeast and southwest?

11 A I don't know that I agree with that sentence.
12 So I don't know how to answer that question.

13 Q Well, Southern Pacific is a competitor of
14 yours for piggyback business across the southern
15 corridor, is it not?

16 A They are a player in the market for
17 containerizable freight in the southern corridor, as are
18 we.

19 Q From time to time, haven't you changed your
20 prices to match the price reductions of Southern
21 Pacific?

22 A And Union Pacific and any number of truck
23 lines.

24 Q I am talking now about Southern Pacific. Have
25 you from time to time reduced your piggyback rates in

1 the southern corridor to meet price reductions of the
2 Southern Pacific?

3 A I imagine. I can't give you any specifics.

4 Q You have no specific recollection?

5 A No.

6 Q Did you ever hear the term "price war" used at
7 the Santa Fe?

8 A No.

9 Q This article says that Southern Pacific's
10 piggyback revenues have jumped 35 to 30 percent. Do you
11 think that is inaccurate? Do you disagree with that?

12 A I don't have an opinion.

13 Q Were you interviewed for this article that is
14 in Fortune?

15 A Yes.

16 Q There is a reference in the article here, and
17 I will quote. It says "Tempers flare at Santa Fe
18 headquarters when Southern Pacific slashes rates or
19 launches an aggressive advertising campaign in
20 competition with Santa Fe."

21 What aggressive advertising campaign in
22 competition with Santa Fe is being referred to there, if
23 you know?

24 A Well, I don't know who the industry insiders
25 are that are being quoted in that sentence. Perhaps it

1 is some Union Pacific people. But I can assure you that
2 tempers don't flare at Santa Fe Railroad.

3 Q Mr. Fitzgerald, that is not my question. The
4 question was whether you can identify the aggressive
5 advertising campaigns by Southern Pacific in competition
6 with Santa Fe that are referred to in this article.

7 A Well, I can tell you that Southern Pacific has
8 an advertising campaign. I don't know whether it is
9 aggressive or not. I can assure you since you read that
10 sentence that tempers don't flare at Santa Fe about
11 aggressive advertising.

12 Q I am trying to get a handle here on the
13 advertising campaign by Southern Pacific.

14 A I would be happy to talk with you about it,
15 but you are quoting a sentence that I don't agree with,
16 and I want to get that of record.

17 JUDGE HOPKINS: I think you have gotten that
18 of record.

19 BY MR. LIVINGSTON: (Resuming)

20 Q Your temper doesn't flare nor does anyone's at
21 Santa Fe.

22 A It is starting to.

23 Q I am satisfied with your answer on that, Mr.
24 Witness.

25 This article indicates that in the fairly

1 recent past there was an aggressive advertising campaign
2 by Southern Pacific aimed at the Santa Fe, and I am
3 asking you whether you are aware of any such advertising
4 campaign.

5 A I am aware of an advertising campaign. I
6 don't know if I would call it aggressive or not.

7 Q Is it aimed at Santa Fe?

8 A I don't think so.

9 Q There is also a reference in the same sentence
10 to slashing of rates by Southern Pacific. Do you know
11 where those rate slashings occurred, and whether that
12 involved the southern corridor?

13 A No, I don't know.

14 Q Are you the fellow at Santa Fe who ought to
15 know whether or not Southern Pacific has been slashing
16 its rates?

17 A You bet.

18 Q And that doesn't ring a bell with you at all?

19 A No, it doesn't.

20 Q Did they reduce their rates at all during 1984
21 in the southern corridor?

22 A I am sure they reduced some and raised some,
23 just as Mr. Edwards says here on the next page.

24 Q You just don't recall the details. Is that
25 what you are saying?

1 A I don't think that there has been any general
2 rate reduction, Mr. Livingston. I am sure that there
3 have been specific rate actions that were intended to
4 capture specific pieces of business. Those go on all
5 the time. I don't recall any in the southern corridor.

6 I am not saying that there weren't any. I am
7 sure there were.

8 Q Since the time you have been vice president of
9 traffic -- that was the beginning of 1983?

10 A Yes.

11 Q Have there been any general rate reductions by
12 the Southern Pacific on traffic in the southern
13 corridor?

14 A I don't know of any. I don't think so.

15 Q And I may have already asked you this, but
16 just to pin it down, since the time you have been vice
17 president of traffic, do you have any feel for whether
18 Southern Pacific's piggyback traffic in the southern
19 corridor has increased significantly?

20 A I expect it has, but I would have to explain
21 why. I don't think it has come out of our business, as
22 I have testified earlier.

23 Q Has your business been increasing at the same
24 rate as the Southern Pacific business?

25 A No. It has been increasing at a lesser rate.

1 Q Prior to the time that Southern Pacific's
2 traffic started to increase, had your traffic shown
3 dramatic increases?

4 A Yes. I think the reason is that we made the
5 commitment toward intermodal much earlier than the
6 Southern Pacific. They are now doing what we did
7 several years ago.

8 In other words, our intermodal market is, I
9 think, at a much more mature stage than the Southern
10 Pacific's is because of the transfer of what had moved
11 in boxcars to TOFC service having occurred much earlier
12 on the Santa Fe than it did at the Southern Pacific.

13 Q I refer you to Page 19 of your statement. The
14 first full paragraph on that page, you talk about the
15 Union Pacific request for trackage rights and you
16 indicate that there are commodities in the territories
17 that would be served by these trackage rights as to
18 which you see no competitive problem caused by the
19 merger.

20 And I gather from your response that you made
21 to Mr. Auerbach that you would regard TOFC traffic as
22 not presenting a competitive problem as a consequence of
23 this merger.

24 A I would certainly put TOFC at the top of the
25 list in terms of not having a competitive problem.

1 Q That is traffic -- you carry a fair amount of
2 TOFC traffic, do you not, from California to Texas and
3 the southeast?

4 A A fair amount.

5 Q That is a significant amount of the traffic
6 that you carry in the southern corridor, is it not?

7 A Yes. Particularly eastbound.

8 Q And today you compete with the Southern
9 Pacific for that traffic.

10 A They are another player in a many-player
11 market.

12 Q That's right, but they are the only rail TOFC
13 competitor in that market.

14 A Well, your own railroad is in that market to
15 some extent.

16 Q From California to Texas?

17 A Yes.

18 Q Do you think the Union Pacific's TOFC
19 offerings are competitive from California to Texas?

20 A I hope not, but I think they are.

21 Q Do you get reports as to the relative shares
22 of TOFC traffic handled by the railroads from California
23 to Texas?

24 A No, we can't get that information. We get
25 stuff through the AAR, I guess, which shows total

1 loadings, but we haven't been able to do anything with
2 specific city pairs. Perhaps the Union Pacific gets
3 that. I would like to know how they get it, though.

4 Q The competition that you have with the
5 Southern Pacific on TOFC traffic in the southern
6 corridor, of course, that competition will be eliminated
7 by the merger, correct?

8 A Well, to the extent that you are able to speak
9 of competition as only involving two railroads, and
10 after the merger you would only have one, I guess that
11 answer kind of gives itself, but you have to keep in
12 mind that in addition to truck and water you have also
13 got the KCS east of Dallas that we work with, and we
14 have got your own carrier that certainly is in that
15 market.

16 Q Do you make an effort to keep your rates
17 competitive with those of the Southern Pacific for
18 southern corridor traffic moving between California on
19 the one hand and Texas-Louisiana on the other?

20 A I think we price relative to trucks. I am
21 sure they do, too, and that probably tends to make the
22 rates pretty comparable.

23 I think as to specific corridors, differences
24 in rail rates are going to be accounted for by such
25 things as proximity of the customers to the ramp,

1 service, length of time it takes to get from origin to
2 destination, and all of those things basically play
3 off. What does a truck charge to go from door to
4 door?

5 Q In fact, isn't it the case that your piggyback
6 rates from points in California to Texas are very
7 comparable to those of Southern Pacific?

8 A As I said, I think they are, and the reason
9 is, they try to snug right up against what the delivered
10 door to door cost is of moving something from -- between
11 those points by highway. Have to stay below it or you
12 don't get the business.

13 Q If today by some administrative fiat Santa Fe
14 was told that it could no longer carry TOFC traffic in
15 the southern corridor, could Santa Fe run a viable rail
16 operation in that corridor?

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1 A If Santa Fe, premerger, standing alone, were
2 told that it could not operate TOFC trains between --

3 Q California on the one hand and Texas,
4 Louisiana and the Southeast on the other.

5 A I don't know. The reason I say that is that
6 even though in the aggregate, TOFC rates are not
7 remunerative or very remunerative, you need to be able
8 to handle a certain amount of traffic over a line in
9 order to cover the fact that the line is there. You
10 need to generate certain density.

11 To the extent density declined, the line
12 generally would become less viable, would be downgraded
13 presumably, and the business would dry up.

14 Q If you could not carry the TOFC traffic, it
15 would have a significant adverse effect on your ability
16 to run a viable rail operation in the Southern
17 Corridor?

18 A At least in the longer term it would.

19 Q At the end of your statement, page 22, you
20 state that the Santa Fe -- and maybe, perhaps you mean
21 Santa Fe Southern Pacific -- would be willing to discuss
22 voluntary trackage rights if the compensation
23 requirements that you have set would be met.

24 Have you, or has anyone at the company,
25 attempted to calculate what a fair amount would be for

1 the trackage rights that Union Pacific has requested?

2 A I have not, and to my knowledge no one else
3 has.

4 Q Why hasn't that been done?

5 A I think we think that conditions are
6 unwarranted and we would be happy to sit down with you.

7 Q Why hasn't Santa Fe -- let me back up. Has
8 Santa Fe made an offer to any of the intervening
9 railroads to provide trackage rights at prices that
10 Santa Fe Southern Pacific think are reasonable?

11 A I don't think that we've gotten that far in
12 any discussions with any of the carriers to discuss
13 price.

14 Q You don't know if anyone has been charged with
15 responsibility of calculating what the rentals would be
16 that you would regard as fair for any of the requested
17 trackage rights?

18 A No, I don't think we've done that.

19 Q Was a policy decision made not to do that?

20 A No.

21 Q Has no consideration been given to figuring
22 out what these fair compensation terms would be? You
23 just dealt with it in the abstract; is that what you're
24 saying?

25 A I'm saying that our conclusion is that since

1 we believe that trackage rights should not be granted,
2 we didn't get on to the second level inquiry, which is
3 if they were, how much would they cost?

4 Now, we are willing to sit down with the Union
5 Pacific. We have sat down with the Union Pacific and
6 talked about areas where there might be operating
7 efficiencies that might be picked up by sharing lines
8 and so forth.

9 We're not interested in sitting down with the
10 Union Pacific and giving it broad access to new markets
11 where the fact of the matter is the density of traffic
12 will only support one rail carrier.

13 Q Mr. Witness, you have gone in this submission
14 to some trouble, Mr. Baumol's testimony and parts of
15 your testimony, to talk about fair compensation
16 requirements. And it doesn't seem to me to be adequate
17 for you to say that the reason you haven't tried to
18 spell out what those compensation requirements would be
19 is that you don't think any trackage rights at all are
20 warranted.

21 MR. NELSON: That's just argumentative. It
22 doesn't sound right to him but he got his answer.

23 JUDGE HOPKINS: We're waiting for a question.
24 I haven't heard any question anyway. Are we arguing
25 with the witness, or what are we doing?

1 MR. LIVINGSTON: I haven't asked the question
2 yet.

3 JUDGE HOPKINS: It was quite extensive. Let's
4 get to a question.

5 BY MR. LIVINGSTON: (Resuming)

6 Q The question is, again, why hasn't anyone made
7 an estimate of what the compensation requirements are
8 that the Applicants would regard as fair for the Union
9 Pacific trackage rights that have been requested.

10 MR. NELSON: I think he's already answered
11 that question.

12 JUDGE HOPKINS: Go ahead, Mr. Fitzgerald. Go
13 ahead again.

14 THE WITNESS: All I can do is reiterate my
15 earlier answer, Mr. Livingston. At this point, no one
16 has come forward from Omaha and asked us to do it. I
17 assume the reason is that your company is interested in
18 bargain basement compensation for the trackage rights it
19 seeks.

20 MR. LIVINGSTON: No further questions.

21 JUDGE HOPKINS: Mr. Kharasch.

22 BY MR. KHARASCH:

23 Q Mr. Fitzgerald, I'd like to get one thing
24 straight at the outset. I believe you told us that you
25 are appearing for the Applicants, plural here; that's

1 Santa Fe and Southern Pacific and, I guess, SFSP
2 Corporation?

3 A That even confuses me, Mr. Kharasch. I'm not
4 sure what I'm doing here.

5 JUDGE HOPKINS: You'd rather not be here?

6 THE WITNESS: For sure.

7 I am employed by Applicant Santa Fe, and I
8 have been designated to be the Senior Vice President,
9 Marketing and Sales, for the new company if and when the
10 merger takes place. And that would be the top traffic
11 official in that company.

12 So that to the extent that there are matters
13 dealt with that deal with the postmerger environment in
14 my statement, I would be, I guess, the most appropriate
15 one to handle those matters in the company. So I guess
16 I have kind of a hybrid role here.

17 BY MR. KHARASCH: (Resuming)

18 Q You seem in your statement to be speaking on
19 behalf of the Applicants, plural; that everybody is
20 pushing this merger.

21 A I think that's right.

22 Q Now, my problem with that is, what happens if
23 there's an inconsistent position? That is, if the Santa
24 Fe and the Southern Pacific have inconsistent positions,
25 who are you speaking for then? Or if those positions

1 are inconsistent with your testimony today, who are you
2 speaking for?

3 A I'm not aware of any inconsistencies, but to
4 the extent that there are inconsistencies, I speak for
5 the Santa Fe today, and postmerger I speak for the
6 merged company. I do not speak for Southern Pacific
7 Transportation Company today.

8 Q And suppose there seems to be an inconsistency
9 between a position stated by, let's say, Mr. Cena and
10 the position stated by you. Whose position governs?
11 Yours or Mr. Cena's?

12 A Well, we need to ferret all that out and see
13 just what that inconsistency is.

14 Q I see. Let's take a position, for example,
15 about the payments that you were just discussing at the
16 end of the Union Pacific cross-examination, payments for
17 trackage rights.

18 Suppose I have here a position and the
19 position says the important point on trackage rights is
20 that the payment should be low enough so that
21 competition can be provided.

22 That doesn't seem to be consistent with your
23 position, but that is the position of the Southern
24 Pacific. Are you aware of that?

25 MR. NELSON: For clarification --

1 MR. KHARASCH: That's a lousy question. Let
2 me strike it.

3 MR. NELSON: Just -- it's out of context;
4 that's all.

5 MR. KHARASCH: Let's have two counsel's
6 exhibits marked. One is the petition for reopen file
7 and finance docket 30,000 on October 9, 1984 by the
8 Southern Pacific Transportation Company, Attorneys
9 Thormund Miller, Douglas Stephenson, Michael Smith, and
10 Stuart Vaughn.

11 JUDGE HOPKINS: What number is that? Do you
12 have the number on that?

13 MS. MAHON: 62.

14 JUDGE HOPKINS: I knew Ms. Mahon would have
15 it.

16 MR. KHARASCH: 62 for identification. And, as
17 number 63, a Southern Pacific petition dated November
18 1984, document dated November 9, 1984, reply to Union
19 Pacific and Missouri Pacific's petition to reopen. That
20 would be MKT-C-63.

21 (The documents referred to
22 were marked Exhibits
23 MKT-C-62 and MKT-C-63 for
24 identification.)

25 MR. KHARASCH: Let's mark as a counsel's

1 exhibit next in order excerpts in this case from the
2 brief of the Atchison, Topeka & Santa Fe Railway
3 Company, finance docket 30,000, March 8, 1982, filed by
4 our friends Mr. Knowlton, Mr. Nelson, Mr. Blaszak, Mr.
5 Wilson, and Mr. Cowell.

6 JUDGE HOPKINS: That would be MKT-64 as I
7 understand it.

8 (The document referred to
9 was marked Exhibit MKT-C-64
10 for identification.)

11 MR. KHARASCH: And if we could mark the reply
12 brief of the Atchison, Topeka & Santa Fe and finance
13 docket 30,000, excerpts again, dated April 23, 1982, as
14 65.

15 JUDGE HOPKINS: They will be marked for
16 identification as MKT-C-65.

17 (The document referred to
18 was marked Exhibit MKT-C-65
19 for identification.)

20 MR. KHARASCH: And since there was a good bit
21 filed in this case, the brief of Southern Pacific,
22 excerpts again, dated -- I think it's dated the same
23 date. I think that's April 23, 1982 also.

24 JUDGE HOPKINS: That would be MKT-C-66.

25 (The document referred to

1 was marked exhibit MKT-C-66
2 for identification.)

3 MR. KHARASCH: The brief, which could be
4 MKT-C-66, Your Honor, is dated March 8, 1982.

5 JUDGE HOPKINS: That would be MKT-C-66.

6 MR. KHARASCH: The reply brief of Southern
7 Pacific in finance docket 30,000, and that would be
8 April 23, 1982. I believe that's MKT-C-67.

9 (The document referred to
10 was marked Exhibit MKT-C-67
11 for identification.)

12 JUDGE HOPKINS: We'll go off the record until
13 we all get copies.

14 (Discussion off the record.)

15 JUDGE HOPKINS: Let's get back on the record.

16 Mr. Nelson.

17 MR. NELSON: Your Honor, I would like to pose
18 an objection at the outset to questions relating to
19 these various documents which have just been marked and
20 distributed in the hearing room.

21 Mr. Kharasch did give us notice that he wanted
22 to ask questions about these documents, and yesterday we
23 received them at the hotel yesterday afternoon. But Mr.
24 Fitzgerald had enough to do without going through all of
25 this material which you will note consists of pleadings

1 filed in some cases by the Southern Pacific
2 Transportation Company in another proceeding, docket
3 30,000, the MP-UP merger case; some cases filed by the
4 Santa Fe.

5 These were not documents, not prepared by or
6 authorized by or, to my knowledge, ever read by the
7 witness. And I think one thing is that they are
8 completely outside the scope of his testimony. And I
9 think it's important also that we're asking questions
10 about things that went on in different cases with
11 conceivably different issues and certainly entitled to
12 different --

13 JUDGE HOPKINS: I think that's happened quite
14 often during this proceeding.

15 MR. NELSON: I know it has, but I wanted to
16 pose my objection at the outset.

17 JUDGE HOPKINS: It's good to pose your
18 objection. But without hearing from Mr. Kharasch, I
19 think we can get into -- if there are any questions that
20 this gentleman particularly can't answer -- that we can
21 go into that at that time and you can object to the
22 particular points.

23 Mr. Kharasch, you state the reasons if you
24 wish.

25 MR. KHARASCH: I have no hesitation in stating

1 the reason for this. It seems to me not only a respect
2 for the decent opinion of mankind, but the force of the
3 position taken by the Applicants is somewhat weakened if
4 they take simultaneously diametrically opposite
5 positions, and I intend to show that they have taken
6 diametrically opposite positions.

7 JUDGE HOPKINS: I'm going to allow you to go
8 ahead, Mr. Kharasch.

9 MR. NELSON: I might just on this, to preface
10 some possible objections down the road, that I'm sure
11 Mr. Kharasch can introduce this material into the record
12 and argue whatever inconsistencies he might discern, but
13 I don't think that any real purpose is served by
14 dragging a witness through the alleged inconsistencies.

15 JUDGE HOPKINS: I don't think Mr. Kharasch is
16 going into it hour after hour. I don't believe he'll do
17 that. I'll allow him to go ahead.

18 Mr. Kharasch.

19 BY MR. KHARASCH: (Resuming)

20 Q Now, did you participate, Mr. Fitzgerald, in
21 the taking, in the formulation of the positions which
22 are expressed in your statement?

23 A Yes.

24 Q Did you participate in discussions in general
25 as to what should be presented by the Applicants at this

1 time in the case?

2 A Yes.

3 Q Did you participate, for example, in decisions
4 as to whether or not to ask Mr. Newton Swain to crank up
5 his remarkable calculator and calculate diversions from
6 the trackage rights?

7 A No.

8 Q You did not participate in that decision?

9 A No. The selection of individuals to prepare
10 various portions of the evidence was not something I
11 participated in.

12 Q Now, just so we don't lose the thread before
13 lunch, the reason for marking some of these exhibits at
14 this time, prior to the major part of my questions about
15 it, was to ask you what's the situation where the
16 Southern Pacific is stating a position diametrically
17 opposed to the position you state?

18 Which is the position of the Southern Pacific
19 -- your statement or the statement in their brief?

20 A I speak for the Santa Fe, premerger, and I
21 speak for the merged company if and when it comes to be,
22 postmerger. I do not speak for the Southern Pacific
23 Transportation Company today.

24 Q Let's look together at page 3 of Exhibit
25 MKT-C-63, sir.

1 A 63?

2 Q Yes. Not 62, but 63.

3 A Page 3? Yes.

4 Q Would you look at the second new paragraph
5 just above the word "argument" in the middle of the
6 page? Do you, sir, agree or disagree on behalf of the
7 Santa Fe and the SFSP that the only sound way to value
8 trackage rights is the way the free market evaluates
9 them: such a free market rental would not exceed the
10 book value of the line multiplied by an 8 percent rate
11 of return, multiplied by the percentage of use.

12 Agree or disagree?

13 A I agree with the first sentence, if I can
14 explain that what I mean by it is the way free market
15 evaluates something is to have a bargain and sale, not
16 an imposition and then compensation as a second-level
17 inquiry.

18 I disagree with the second sentence.

19 Q You disagree with the second sentence?

20 A Sure.

21 Q That's not correct?

22 A It sure isn't.

23 Q Without going through this in too much detail,
24 do you agree or disagree that the Commission's
25 objectives in granting trackage rights is to permit

1 competition for traffic moving over the segment
2 represented by a trackage right?

3 A As I testified in reply to Mr. Livingston's
4 question, when the ICC grants trackage rights, it then
5 has to turn around and provide a financial inducement
6 for the carrier getting them to use them. And that's
7 the reason for having to impose bargain basement prices.

8 Otherwise, the carrier couldn't use them,
9 couldn't afford them.

10 Q I was looking at the route map which is up on
11 the wall of the SFSP, and I see some trackage rights
12 indicated between Kansas City and St. Louis.

13 Are you and I on the same wavelength in
14 understanding that those were granted to the SP in a
15 Union Pacific case?

16 A Yes.

17 Q And is it the intention of the SFSP to use
18 those trackage rights in the operations planned for the
19 SFSP?

20 A Yes.

21 Q Do you have any other way, in fact, of getting
22 to St. Louis directly?

23 A Yes.

24 Q How is that?

25 A On the Cotton Belt from the south.

1 Q Is that a direct way to get there?

2 A It depends on where you're coming from.

3 Q If you're coming from Los Angeles or that
4 area, is it a direct way to get to St. Louis to use the
5 Cotton Belt without using the SFSP trackage rights
6 between Kansas City and St. Louis?

7 A Well, it's less direct than using the UP's
8 trackage rights. That's the reason we proposed to use
9 them. The Commission is going to give them away; we are
10 going to use them.

11 Q And is it the position of the SFSP that it
12 will pay for those trackage rights with the Union
13 Pacific at arm's length, which is to bargain with you,
14 to charge you, or that you will pay the amount the
15 Commission determines?

16 A It's a matter that the Commission is
17 handling. I assume that whatever the answer is, the
18 Commission will tell us and that's what we'll pay.

19 Q And if the Southern Pacific, in its petition
20 to reopen, is successful in having the amount the
21 Commission has set reduced, you will pay the reduced
22 amount?

23 A Sure, whatever the Commission says.

24 Q Now, do you think it's important, sir, as you
25 approach this case, to observe what the Commission has

1 taught in other cases and observe these teachings in
2 this case?

3 A I think it's more important to try to instruct
4 the Commission on what's going on in the market today.
5 I think that stare decisis has a role, but I think that
6 the Commission is in a position where it has to learn
7 what's going on in the current environment.

8 That's why I'm here.

9 Q To instruct the Commission?

10 A Yes, sir.

11 Q Have you observed that there is any change
12 since the Union Pacific decision? Let me stop. Have
13 you read the Commission's decision in finance docket
14 30,000?

15 A I may have. I just don't remember. I haven't
16 read it in years, if I did.

17 Q Do you know what the position of the Santa Fe
18 was in finance docket 30,000?

19 A Yes. It opposed the merger.

20 Q Do you know what the position of the Southern
21 Pacific was in that case?

22 A It opposed the merger, but it also sought
23 trackage rights, and I guess various kinds of relief. I
24 don't know it in detail.

25 Q Who wrote the footnote at pages 12 to 13 of

1 your statement?

2 A I don't know; various members of my staff.

3 Q It's about what economists explain.

4 A Various of my staff have worked on this
5 statement, and I prepared the thing. It was originally
6 -- the footnote was originally part of the text. And I
7 relegated it to footnote status because I felt that was
8 where it more appropriately belonged.

9 Q Are these lawyers on your staff, or economists
10 on your staff, or staff on your staff -- railroad
11 traffic people?

12 A Mr. Reyff has been involved with my statement;
13 Mr. Lawson. I think you've met both of them. Also, a
14 number of lawyers and myself who have all contributed to
15 the final product. Just exactly who wrote that, I'm not
16 sure.

17 Q I have had a lot of pleasant relationships
18 with railroad traffic people and I find that they do not
19 often speak of misallocation of resources.

20 A Well, you're looking at the new breed, Mr.
21 Kharasch. I do.

22 Q And do you agree that on page 13, that society
23 is properly concerned about preventing firms from
24 exercising so much market power that they earn monopoly
25 profits?

1 In general, is that a correct statement?

2 A I think so.

3 Q Let's talk a minute about arm's length
4 bargains for rail facilities. Do you follow the
5 transactions in the railroad industry in recent years as
6 part of your job?

7 A I try to.

8 Q Was the Milwaukee a prosperous railroad in
9 1983-1982?

10 A No.

11 Q The Milwaukee has recently been sold for a
12 rather large sum of money, has it not? There was brisk
13 bidding, was there not?

14 A I can't agree with you that it was sold for a
15 large sum of money, in that I suspect it was sold for
16 considerably less than its net salvage value. The
17 assets of that company sold at a substantial reduction
18 to what would have otherwise been their market value by
19 reason of the fact that the company was a railroad. And
20 that is not a very remunerative place to put your
21 assets.

22 Q Why would anybody pay upwards of half a
23 billion dollars for the Milwaukee, sir?

24 A I'm sure even the Soo Line is wondering about
25 that today.

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1 Q You think that was not a good move?

2 A I don't think so.

3 Q And then the Chicago and North Western was
4 still more foolish in offering three-quarters of a
5 billion dollars for it?

6 A And I think they recognized that when they
7 took a quick exit.

8 Q The price of the Milwaukee, might it not
9 reflect the fact that the Sco Line wanted access to the
10 Kansas City market?

11 A It might, but if that was the reason for it, I
12 question the wisdom of it. It's one of the most hotly
13 competitive rail markets in the country. There is more
14 service between Chicago and Kansas City than can
15 possibly make the least efficient or at least two
16 efficient carriers in that market whole.

17 It's a bargain basement market.

18 Q Now, was there a railroad, an independent
19 railroad, called the Frisco?

20 A Well, there was.

21 MR. NELSON: Your Honor, I'd like to object to
22 this line of questioning.

23 JUDGE HOPKINS: Where are we going, Mr.
24 Kharasch?

25 MR. KHARASCH: We are going to test a

1 witness's statements, which throughout his statement
2 here -- and I'll find you some examples if you want --
3 that there's no question at all that joint routes will
4 be continued and that we're testing the basis of his
5 statement that market power is not going to be acquired
6 by the merger.

7 JUDGE HOPKINS: How far are we going?

8 MR. KHARASCH: Well, if other people find that
9 getting access to markets or eliminating competitors is
10 worth a good bit of money of railroads, I think it
11 follows --

12 JUDGE HOPKINS: I understand. But how far are
13 we going?

14 MR. KHARASCH: If you think the point is made,
15 I might desist. Let me ask a wrap-up question.

16 JUDGE HOPKINS: Thank you. Go ahead.

17 BY MR. KHARASCH: (Resuming)

18 Q Do you think the fellow that bought the D&RGW
19 -- was he foolish?

20 A I don't believe that he necessarily was.

21 Q Well then, tell us when a rail connection is
22 worth a lot of money and when it isn't.

23 A Well, Mr. Anschutz paid about \$500 million for
24 the Rio Grande. Out of that, he got something in excess
25 of \$200 million in cash and marketable securities. So

1 his purchase price going in is down to \$300 million or
2 so.

3 Rio Grande today, I suppose, might be
4 projected to earn something on the order of \$30 million
5 a year in an average year. That means he's paying ten
6 times earnings. And if everything goes down the chute,
7 he's picking up, net salvage value, probably well in
8 excess of the \$300 million.

9 Q The acquisition of the Frisco by the BN?

10 A That one is sufficient remote in time that I
11 just don't remember the terms.

12 Q How about the acquisition of the MP by the UP?

13 A That involved an exchange of stock at levels
14 that I really never had the interest, not owning any
15 stock in either of those companies, to determine whether
16 it was a good deal for one or other of the parties. But
17 Union Pacific, as I recall that deal -- and please
18 understand, I don't recall it well -- simply exchanged
19 stock with the Missouri Pacific. It didn't cost them
20 anything in a real sense.

21 Q New topic. Ten percent increase in the rates
22 of the Santa Fe would yield approximately how much money
23 a year?

24 A Well, last year we had revenues of about \$2.3
25 billion, so 10 percent of that would be \$230 million.

1 Q Ten percent increase in the rates of the
2 Southern Pacific?

3 A It would be on the same order.

4 Q So are we in the range of half a billion
5 dollars a year if we could add 10 percent to the rates
6 of each of these?

7 A If we could.

8 Q If we could.

9 A I'd like to hire you if you could show us
10 how.

11 Q I think I can. I think I can. I won't even
12 charge you 1 percent.

13 A I'm going to lean forward in my chair.

14 Q If you hire me.

15 I think I heard a very interesting phrase
16 which I would like to use, and not to repeat the
17 examination, but I think it is helpful in
18 understanding. You are saying -- you said earlier in
19 this cross-examination that railroad prices are "snug up
20 against truck prices."

21 A Sorry. I've been hanging around the
22 traditional traffic guys too long.

23 Q Snug up against. Mr. Dimmerman might use that
24 phrase.

25 A He might. He might.

1 Q That means, let's say, the truck price for a
2 given piece of transportation is, let's say, \$10. The
3 railroad competing with the truck will come up to
4 \$9.90.

5 A Sure.

6 Q We must include in price such convenience
7 prices; the truck convenience must be kept in price, too
8 -- convenience of using truck, and speed, and that sort
9 of thing.

10 A Yes. Let me maybe just describe it to you a
11 little bit differently and get the same point across.
12 If in your example the truck price is \$10, a railroad
13 competing against that truck line has to come in with,
14 as you say, \$9.90 or something.

15 But the \$9.90 has -- and that dime is to
16 account for the fact that generally the trucker can get
17 it there quicker and tailor the service and so on. Now,
18 the \$9.90 has some components to it.

19 One is the rail rate. Another is the drayage
20 at both ends. And a third is a profit for a middle man,
21 typically known in railroad traffic jargon as a third
22 party.

23 Those three added together can't exceed
24 \$9.90.

25 Q If you didn't charge as much as \$9.90, you

1 would in traffic man's jargon, be leaving something on
2 the table.

3 A Sure. That's right.

4 Q Now, I have observed that railroads currently
5 are very anxious to get more traffic. Would you think
6 as a general observation that's correct?

7 A Some more than others.

8 Q And what with the Staggers Act, people even
9 conduct a kind of competitive offer; that is, railroads
10 conduct a competitive offering to shippers when they
11 compete, do they not?

12 A I think what you're asking me is whether
13 shippers --

14 Q Seek competitive bids.

15 A Yes. And in some form or other, they do.
16 They may not be closed bids or something, but they will
17 shop a particular piece of transportation business
18 around to all the players looking to handle some
19 freight.

20 Q And your general traffic responsibilities, are
21 you interested in General Motors' traffic?

22 A Very interested.

23 Q And indeed, have you followed what's happening
24 to the rail service at the plant where G.M. and Toyota
25 are planning to have a joint manufacturing facility?

1 A This is the Nummi plant?

2 Q N-u-m-m-i.

3 A In Fremont? Yes, I'm observing that with some
4 considerable concern.

5 Q Tell me why you observe it with concern, sir.

6 A The Union Pacific is involved in, I guess, a
7 Commission proceeding against Southern Pacific at this
8 point, the net effect of which, as I understand it, is
9 Southern Pacific should lose and Union Pacific prevail
10 -- would be that Union Pacific would supplant Southern
11 Pacific as the carrier at that plant which I guess is
12 now under construction.

13 And as the chief traffic officer of the merged
14 carrier, if and when that happens, that would be a very
15 major industry which would be lost to the merged
16 carrier

17 Q That's an existing facility, is it not?

18 A It's existing, but it's shut down.

19 Q And there is SP track at that facility?

20 A Currently collecting rust, I guess.

21 Q And Western Pacific is a few hundred feet
22 away, 400 feet away?

23 A It's the old Western Pacific line.

24 Q Yes. The old Western Pacific now turns out to
25 be Union Pacific.

1 A Unfortunately so.

2 Q Now, I have been reading with some interest
3 the Commission's decision in finance docket 3568 of
4 March 29, 1985. Did you happen to see that?

5 A No. I just had to console myself with reading
6 Traffic World about it.

7 Q Well, did your Traffic World researchers tell
8 you that according to the Commission, SP and UP became
9 involved in intense bidding with General Motors for this
10 traffic?

11 A I'm aware of that of my own independent
12 knowledge.

13 Q They bid back and forth, the two railroads.

14 A They did. That's right.

15 Q And apparently, UP made the lowest bid.

16 A Typical of a merged carrier to be able to come
17 in with lower rates.

18 Q And it must be that some of this GM traffic is
19 going to move by railroad instead of by truck. So would
20 you guess that the UP has bid lower than what truck
21 rates would be to move cars from that facility?

22 A For setup automobiles?

23 Q Well, you say you know something from of your
24 own knowledge about what's going on there. What is it
25 that's being bid between SP and UP? Is it raw materials

1 in, or parts, or what?

2 A As I understand the Union Pacific's proposal,
3 and this is really one of the beauties of being such a
4 large efficient carrier and something that our merged
5 carrier is really only trying to replicate on a small
6 scale, the Union Pacific was trying to go to General
7 Motors and put a very comprehensive package together
8 which no single carrier the size of the Southern Pacific
9 could hope to match.

10 It included parts in from various locations,
11 TOFC piggyback. Then the Union Pacific turned around
12 and put in reduced rates using the same trailer
13 equipment back east which impacted us because we are in
14 the Bay area.

15 And then the Union Pacific came in with some
16 very attractive rates from the standpoint of General
17 Motors out of the east, the Detroit area, into the
18 Fremont area and then paired that up with a very
19 attractive single line offer back out of the Bay area at
20 Fremont with the Nummi automobiles.

21 That's really the kind of thing that we are
22 looking to do in this merger on a basis that will keep
23 us much more competitive for large blocks of traffic,
24 like Union Pacific has been able to siphon away from SP
25 as part of this deal.

1 Q And the Union Pacific power resided in its
2 ability to tie together the traffic from one place and
3 the traffic from another, did it not?

4 A That's the way I understand it. And I talked
5 with everybody from Jerry Bodrie at General Motors about
6 it, to the Union Pacific people. They are very
7 impressed with their ability to be able to do that.

8 Q Now, the Union Pacific proposition, back to
9 that subject, has to be a lower rate proposition than
10 the trucks would offer from Detroit; right?

11 A If you say so. I don't know.

12 Q As a traffic man, don't you have to offer a
13 lower rate than the trucks? You may be snug up against
14 the trucks, but you have to be lower than the trucks.

15 A Well, keep in mind that what we're talking
16 about when we're talking about snug up against the
17 trucks was the TOFC kind of a setting, which is really a
18 much simpler thing to understand from the logistics
19 point of view than a movement of setup automobiles and
20 so on.

21 Q Well, if Union Pacific did not offer General
22 Motors lower TOFC transportation from this plant, then
23 why would they be offering General Motors anything
24 desirable as far as that TOFC, unless they're offering
25 lower than trucks?

1 It doesn't add to the package unless they give
2 them a lower-than-truck rate TOFC rate. Isn't that
3 right?

4 A I think that question is incomprehensible.

5 Q Union Pacific you said -- let's take it in
6 pieces. Fair enough.

7 Union Pacific, you said, came to General
8 Motors and offered a number of pieces of transportation
9 together in a bid.

10 A All rolled together. You might call it a
11 tying agreement.

12 Q One of those pieces, sir -- my mind is very
13 devious -- one of those pieces was TOFC traffic, you
14 said -- I believe you said.

15 A Yes, TOFC traffic. Parts traffic. Yes.

16 Q That was one of the pieces.

17 A Yes.

18 Q Now, if that piece of the deal did not offer
19 TOFC rates lower than the rates that General Motors
20 could get from a trucker, that piece of the deal wasn't
21 an attractive piece of the deal; it was anti-attractive
22 piece of the deal.

23 A I follow you.

24 Q True or not?

25 A I don't know. I'm sure you were looking for a

1 yes, but the reason I have to say I don't know is that
2 General Motors has come to us on a number of occasions
3 and talked to us about what our posture might be
4 postmerger.

5 And generally what General Motors, and for
6 that matter, a number of large steel companies and other
7 large traditional American industries are interested in
8 is packaging transportation services and, to some
9 extent, kind of contracting out the logistics function
10 to major carriers that are going to be multimodal.

11 And it may be that that specific part, the
12 TOFC part, was not an advantage standing alone to
13 General Motors, but when put together in the package,
14 the package was sufficiently attractive that it was in
15 the aggregate such that they decided to do it.

16 Now, I don't know.

17 Q Did the Santa Fe bid for transportation from
18 this plant?

19 A For the little bit of it that we could be
20 involved in, we sure did.

21 Q What's the little bit you could be involved
22 in?

23 A We were bidding on the westbound portion of
24 the setup automobile business.

25 Q Where is this plant?

1 A The plant that's the subject of that
2 proceeding is at Fremont, California. General Motors is
3 everywhere. The part that we were involved in was
4 inbound setup; that is to say, completed automobiles out
5 of the East into that plant where the multilevel cars
6 would be reloaded with the Nummi automobiles for
7 shipment East.

8 Q I'm not following that. You were involved in
9 bringing cars from Detroit to California in order to
10 ship them back out to California?

11 A Not the same cars, Mr. Kharasch. Look, what
12 we have here is a network. We have cars that are
13 especially adapted to handle setup completed
14 automobiles. Those cars operate in a network, a
15 national pool.

16 What General Motors and Ford and Chrysler and,
17 to some extent, the import automobile companies do is to
18 put together a network which is going to minimize the MT
19 movement of this multilevel automobile equipment.
20 General Motors, when it decided it was going to, as you
21 put it, put this business out for bid, contacted various
22 carriers and asked them to submit offers on parts for
23 all of it, and generally speaking, the direction they
24 have taken is to favor a carrier that's able to put
25 together all of it.

1 And at any rate, the part that we were
2 interested in before it was determined to go with Union
3 Pacific was the part of American-made automobiles coming
4 out of the Detroit area, going into Fremont, where those
5 American cars would be offloaded and pedaled out by
6 highway to GM's dealer network.

7 The MT rail cars will then be loaded with
8 these Nummi automobiles and shipped East -- now, as it
9 turns out, on the Union Pacific -- to some automobile
10 prep sites or whatever unloading facilities, where again
11 they will be pedaled out by highway to the dealer
12 network.

13 Q General Motors wishes now to use Union Pacific
14 for this plant.

15 A That's what I'm told, at least for the term of
16 the contract that they have agreed to.

17 Q The Southern Pacific has begun a proceeding at
18 the Interstate Commerce Commission trying to keep Union
19 Pacific from building a track. Is that right?

20 A That's right.

21 Q General Motors, although the largest auto
22 manufacturer in the country, does not have enough
23 leverage with Southern Pacific to make them let Union
24 Pacific into the plant. Is that correct?

25 A They're certainly making them bleed.

1 Q Well, but Southern Pacific has nevertheless
2 persisted in saying it has the legal right to keep the
3 Union Pacific out.

4 A What can it do? My understanding from General
5 Motors is that they have already taken the business that
6 they intended to take away from the Southern Pacific
7 away from it.

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1 Q So General Motors has no remaining leverage
2 with Southern Pacific?

3 A That may well be.

4 Q And how about Santa Fe? Do they have leverage
5 with Santa Fe?

6 A Sure. And they have talked to me about it,
7 too.

8 Q Now --

9 A They have incredible leverage.

10 Q But the leverage hasn't gotten the UP into the
11 plant.

12 A Because the Southern Pacific is apparently
13 willing to roll the dice and come up a loser.

14 Q What is the losing?

15 A General Motors told me it diverted from
16 Southern Pacific, as a result of this action by Southern
17 Pacific, traffic worth \$50 million a year.

18 Q So you think that the plant looks like it's
19 worth more than \$50 million?

20 A I said I think they're a loser. I think it
21 was a big mistake.

22 JUDGE HOPKINS: I think this would be a good
23 time for a recess. We'll recess until 2:00. And I'll
24 notify you now, we will start at 9:00 o'clock tomorrow
25 morning rather than 9:30.

1 (Whereupon, at 12:45 o'clock p.m. the hearing
2 recessed, to reconvene at 2:00 o'clock p.m. this same
3 day.)
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AFTERNOON SESSION

(2:00 P.M.)

JUDGE HOPKINS: Let's get back on the record.
Mr. Kharasch.

Whereupon,

THOMAS J. FITZGERALD

the witness on the stand at the time of the recess resumed the stand, and having been previously duly sworn by the Administrative Law Judge, was further examined and testified as follows:

CROSS EXAMINATION - RESUMED

BY MR. KHARASCH: (Resuming)

Q Mr. Fitzgerald, picking up the topic we were discussing before the lunch break, is it possible for a trucking company to compete for the kind of traffic that comes in and out of the General Motors plant or automobile manufacturing plant generally?

A Yes. I think it is. And I think they probably have been awarded at least some parts of it, although I can't tell you which parts.

Q Can a trucking company compete for all the type of service that you understand General Motors was asking at the plant?

A I don't know that a single truck company could, but I think in the aggregate, truck companies

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1 collectively could.

2 Q Why could a single truck company not?

3 A I just don't know of any of them that would
4 have the different types of equipment that would be
5 required presently. I would certainly think that any
6 period of time they could gear up to compete, a single
7 one of them, but I don't know that any of them has the
8 size, the equipment, to be able to take that on, in
9 addition to whatever other business commitment they
10 might have today.

11 Q So it looks like for this G.M. plant that
12 there was competitive bidding or competitive tenders
13 being offered by railroads and truck companies, and the
14 railroads in general seem to have won out in a good bit
15 of the traffic at least.

16 A Certainly a good bit of the trafffic.

17 Q And as to the two railroads that were
18 principally interested in the traffic, the UP seems to
19 have offered a better package than SP.

20 A Better in the eyes of General Motors. They
21 seem to have accepted it.

22 Q Now, there's one point left over from before
23 lunch that I've been able to refresh my recollection at
24 the map. If I talk loud, could you turn around and look
25 at the map?

1 A Yes, sir.

2 Q On your map, the red is the SP and the blue is
3 the Santa Fe. And when we get to Kansas City here, to
4 get over to St. Louis, it has to be, it seems to me, if
5 you are at Kansas City, it has to be by the trackage
6 rights of the SP between St. Louis and Kansas City.

7 A Well, I don't know that that's entirely true,
8 at least in theory. The Southern Pacific purchased the
9 trackage of the Chicago Rock Island Pacific. I guess
10 it's part of the Tucumcari purchase, but in any event
11 they purchased it.

12 Now, as I understand it, portions of that
13 railroad are either not operable or are only operable at
14 very slow speeds. And when the opportunity presented
15 itself to the Southern Pacific to jump in with the
16 UP-MP-WP merger case and try to get trackage rights,
17 rather than rehabilitating their own line between Kansas
18 City and St. Louis, they jumped on it.

19 Q Is the old Rock Island Line shown at all on
20 this map, which I believe is the map the SFSP submitted
21 to the Commission as their system map? Is it shown in
22 color on this map?

23 A I have a smaller version of the same thing
24 you're looking at and apparently west out of St. Louis
25 and east out of Kansas City, there do appear to be two

1 separate rail lines that look as if they converge for
2 the center portion there between the two cities.

3 But to be honest with you, I really don't know
4 whether those are intended to depict operation over the
5 Rock Island or not.

6 Q In any event, I think you answered earlier
7 that after an SFSP merger, if it's approved, you would
8 intend to operate over the trackage rights.

9 A That's the present plan. Now, if we had to
10 pay what I contend is the appropriate price, presumably
11 the cheaper answer would be to rehabilitate the Rock
12 Island or to buy another railroad that's out there.

13 Q In the case of the GM plant that we were
14 discussing, was there any inter -- i-n-t-e-r -- modal
15 service that was successful in bidding for the traffic;
16 that is, rail and truck combined?

17 A Yes, I guess, as I understand your question.

18 Q Describe that service.

19 A The Union Pacific is handling automobile parts
20 out of various apparently eastern origins into its ramp
21 at Oakland, and then trucking over to Fremont.

22 Q When one looks at an intermodal movement, I
23 think you described before, you have to look at -- I
24 suppose it's truck/rail. You have to look at the cost
25 of loading into the truck, the trucking costs, the costs

1 of loading out of the truck into the rail car, and then
2 at destination.

3 A No. I guess we're not talking about quite the
4 same thing. You're speaking of what traditional
5 railroad types would refer to as transloading. When I
6 talk about intermodal, I'm talking about a trailer
7 that's backed up to the customer's dock, it's loaded
8 into the truck that goes in the near railroad piggyback
9 ramp. The trailer is physically lifted, whether
10 mechanically or up an incline, onto a rail flatcar,
11 shipped to destination, and then the procedure is
12 reversed; off the rail car, onto the highway, and out to
13 the consignee's dock.

14 That's what I refer to as our intermodal
15 service offering.

16 Q Now, are there other types of intermodal
17 service such as service that comes from, let's say,
18 trucking to a point where the commodity is loaded into a
19 rail car?

20 A Yes. And as I say, customarily we would refer
21 to that as transloading.

22 Q Transloading. And in transloading to see
23 whether that is economic, you have to see what the costs
24 are of the loading into the truck, if that's the first
25 load; the truck transportation; the offloading of the

1 truck into a rail car; and then the rail
2 transportation.

3 A Sure.

4 Q Is the trackage right operation between Kansas
5 City and St. Louis of the SP, in your judgment,
6 efficient?

7 A I don't know anything about the operation per
8 se.

9 Q Would you define what you mean by efficient as
10 used in your statement?

11 A What page?

12 Q You used the word several times throughout the
13 statement.

14 A I would appreciate it if you would let me try
15 to define it in the context in which I use it.

16 Q You say you would maintain efficient joint
17 routes at page 9. Define "efficient," please.

18 A I think we discussed this subject last time.
19 This is with reference to the joint route and rate
20 policy that we enunciated in October. And efficient in
21 this context means, as I suggested, a variety of factors
22 going into the determination of route efficiency. One
23 is certainly the customer's preference; another is
24 service, direct as against circuitous; the general
25 traffic levels that can be marshaled to move over a

1 particular gateway; all those things, together with the
2 cost of the participating railroads would be factors
3 that were on efficiency.

4 Q You are not able, as you use the term on page
5 9 or elsewhere in your statement, to give us a formula
6 for efficiency? It isn't cost just, is it?

7 A It's not just cost.

8 Q The lowest cost route is not necessarily the
9 most efficient route.

10 A I would say that generally however, the lowest
11 cost route is the most efficient route; yes -- if you
12 capture all the costs.

13 Q And those elements of cost I believe you told
14 Mr. Auerbach this morning, are variable cost, full cost,
15 and profit?

16 A Yes.

17 Q And those have to be recaptured in measuring
18 efficiency?

19 A I think as you measure efficiency, you can
20 generally concentrate on the variable cost because the
21 others, fixed and the cost of capital, are generally
22 going to be givens in this equation.

23 Q When you say on page 9 that you will maintain
24 efficient through routes -- now, you are going to then
25 maintain routes that are the lowest variable cost

1 route?

2 A I would think so; yes.

3 Q Let's say we are comparing a joint route of A
4 and B. The joint route of A and B has to be lower
5 variable cost than the single line route carrier A alone
6 for you to maintain the route. Is that right?

7 A No. We'll maintain the route in any event.

8 Q Oh, you'll maintain all routes, whether or not
9 they're efficient? Is that what you mean?

10 A Sure.

11 Q That's not what you say on page 5 -- page 9.
12 You don't say you'll maintain all routes. You say
13 you'll maintain efficient through routes.

14 A Well, that's really together with the notion
15 that the route, of course, is going to be used; that if
16 the customer uses the route, we're going to maintain the
17 route.

18 Q So we should restate what your policy is going
19 to be in the future. You say your policy will be to
20 maintain all through routes that customers use.

21 A We will provide service to any gateway where
22 the customer wants it, commensurate with collectively
23 the customer's willingness to use the route. Yes.

24 Q I don't think you're answering my question
25 directly. And I believe -- it's a question of

1 maintaining efficient through routes. You underlined
2 the word "maintain" on page 9 of your statement.

3 Now, when you say you will maintain efficient
4 through routes, do you mean that you will maintain all
5 through routes that the customers use?

6 A Assuming that collectively the customers use
7 it to the extent necessary to cover the cost of staying
8 in business at that location.

9 Q Whose cost of staying in business?

10 A Ours.

11 Q You mean you might abandon trackage. We
12 understand that.

13 A Yes.

14 Q But if you don't abandon the trackage, are you
15 committing Santa Fe Southern Pacific to maintaining all
16 through routes that customers use?

17 A That's exactly what I'm doing. And what I'm
18 saying is that the cost that we charge is going to be a
19 reflection of our cost in that regard, but the route
20 will be there.

21 Q The route will be there, but you might raise
22 the rates if you're not making enough money.

23 Now, if what cases will you raise the rates?

24 A If they're failing to cover our costs.

25 Q And your costs are what? Variable costs? As

1 that what you told me?

2 A Variable costs at the minimum. And beyond
3 that, you need some contribution above and beyond.

4 Q And how much is the contribution that you will
5 require in order to maintain a joint --

6 A I can't tell you that in any given case. As
7 you know, the Commission is authorized and the industry
8 requires the ability to price differentially, and we
9 will continue to do that.

10 Q Well, I'm not interested in the pricing
11 differential. I'm interested in your so-called
12 commitment to maintain efficient through routes and
13 services, which you talk on page 9 and elsewhere on your
14 statement.

15 A Which doesn't say anything, sir, about rates.

16 Q You're just saying the route will remain
17 open.

18 A I don't know why that is so hard to
19 understand.

20 Q The route will remain open if it's used,
21 whether or not it's efficient. Is that what you mean?

22 A I'm saying that insofar as there is use made
23 of a particular route, to the extent it is economical
24 for us to stay in business, we will continue to allow
25 traffic to move in that regard.

1 Q To the extent it's economic for us to stay in
2 business means that you won't abandon the track.

3 A Or the interchange.

4 Q Or the interchange. And that is covering your
5 variable costs? Or do you require more than that?

6 A Well, I don't think I've dealt with the
7 subject of costs in that regard, have I?

8 Q I don't know. It's your commitment that you
9 say that the ICC has simply to hold you to if you do
10 anything contrary to it.

11 A If we can cover our variable costs, I can't
12 think of a single instance in which we would not want to
13 continue to provide service.

14 Q Now, let's talk about rates over these joint
15 routes. What is your commitment, if any, about rates
16 that you want the Commission to hold you to?

17 A The third sentence of the first paragraph,
18 SFSP-C-2, says that: "Postmerger decisions with respect
19 to joint rates will be made on a case-by-case basis
20 based on the relative cost and service capabilities of
21 the respective routes, as well as the transportation
22 needs of our shippers."

23 That's the operative sentence with respect to
24 rates.

25 Q Let's see if we can sharpen up that sentence

1 so we know your meaning. It will be based on these
2 factors in what way?

3 MR. NELSON: Your Honor, I'd like to object to
4 this line of questions because it was gone into ad
5 nauseum in October, this very same document, by Mr.
6 Kharasch.

7 MR. KHARASCH: No, I never had this document.
8 I am reading page 9. I see it on page 18, and I see it
9 through the testimony here. "All the Commission has to
10 do is hold us to our policy."

11 JUDGE HOPKINS: You've been arguing this
12 efficiency for some time.

13 MR. KHARASCH: I want a definition. I'm not
14 arguing with him.

15 JUDGE HOPKINS: I thought we had said before
16 it's rather difficult to come up with an exact
17 definition of efficiency.

18 MR. KHARASCH: Oh, I don't think their
19 commitment means -- it means nothing at all. It's a
20 useless commitment. But they seem to mean something by
21 it, and this is supposed to protect us against
22 anticompetitive effects. So I think I'm entitled to
23 inquire if he is emphasizing it on pages 9 and 18, and I
24 will find some more if you want, what he means by what
25 he says.

1 MR. NELSON: He explained what he meant by the
2 policy which is merely being quoted on page 9.

3 JUDGE HOPKINS: Go a little more, but not too
4 extensively, Mr. Kharasch.

5 BY MR. KHARASCH: (Resuming)

6 Q Let me ask you something rather simple. You
7 underline on page 9 the word "maintain efficient through
8 routes." Does that imply that you are not committing to
9 establish any new efficient routes, just keep those
10 you've got?

11 A Well, that's intended to say that we're not
12 holding ourselves out to creating new efficient joint
13 routes. On the other hand, the AAR-NIT League agreement
14 in Ex Parte 456 does have a section, Section 5
15 specifically as I recall it, which deals with the
16 establishment of new joint routes.

17 And to the extent that that ultimately finds
18 its way into the Code of Federal Regulations, we are
19 indeed holding ourselves out to establishing new
20 routes.

21 Q Is there any case in which you would establish
22 a through route or a through rate with someone else
23 where you would make less profit than you would if you
24 carried it yourself, even though a new route might be
25 more efficient?

1 A We have presently in effect a great many joint
2 rates with our friendly connections. The sum and
3 substance of the AAR-NIT League agreement is to
4 essentially freeze in place all existing joint rates
5 that are in fact used by shippers.

6 In the event we were to endeavor to cancel a
7 joint rate, assuming this does become part of the CFR,
8 anyone finding that conduct to be anticompetitive or
9 otherwise objectionable would have the right to make
10 such assertions before this Commission. And assuming
11 that they were able to prove those assertions, we would
12 be prohibited from canceling the joint line rates.

13 So the answer is certainly to the extent that
14 we have in place joint rates now which would earn less
15 money than single line rates, we would keep them. And I
16 might go a step further and say we're still making joint
17 rates with your company by contract which afford us
18 considerably less profit than we would get if we handled
19 the traffic single line. And I suspect that in view of
20 the desire of customers to handle traffic in a variety
21 of ways, that we'll continue to do so.

22 Q The machinery then that you think the
23 Commission would use, according to your statement on
24 page 18, to hold you to your policy is such machinery as
25 might come out of this NIT League AAR agreement?

1 A The Commission has power to hold us to this
2 agreement which is found in the statute and exists
3 separate and apart from anything that may come out of
4 the AAR-NIT League agreement.

5 Q That's about canceling rates? I mean
6 canceling routes.

7 A Yes.

8 Q Do you think the Commission has any power to
9 force you to create new efficient joint routes?

10 A Yes.

11 Q Does the Commission have any power to force
12 you to make contract rates with anyone else?

13 A I have to say I'm not aware of any such
14 power.

15 Q Have you in recent years seen any Commission
16 proceeding in which anyone was forced to make a joint
17 rate?

18 A No, but I seen cases where the Commission has
19 directed what a particular rate should be. Now, whether
20 it's a contract or not is probably less important than
21 the substance.

22 Q In general, do you think it's a good idea, Mr.
23 Fitzgerald, to have the Commission actively engaged in
24 day-to-day regulation of railroad rates?

25 A No, I don't think it's a good idea.

1 Q Let's turn to a new topic for a moment. Was
2 the Santa Fe affected, as predicted, by the result of
3 the Union Pacific/Missouri Pacific decision?

4 A In what respect?

5 Q Did you lose traffic as predicted?

6 A Let me just say, I don't know about the "as
7 predicted" part, because I don't know what those
8 predictions were. But I can tell you, we lost traffic
9 and are continuing to lose traffic.

10 Q As a result of the UP-MP-WP merger?

11 A Yes.

12 Q And have you found that the Union Pacific has
13 been successful in diverting traffic?

14 A Yes. They do it, I might say, by lowering
15 rates, not by increasing them. And I would suspect that
16 the noose would get even tighter around the Santa Fe's
17 neck if in fact the much talked about merger between
18 Union Pacific and your client comes to pass.

19 Q Two such powerful railroads would surely be a
20 competitive force.

21 A Indeed.

22 Q Two such efficient railroads.

23 A I should say.

24 Q You used the word "friendly connection" in
25 your answer a couple of questions back. Would you

1 define what you mean by friendly connection?

2 A Friendly connection is a railroad that has a
3 positive motivation in wanting to work with the railroad
4 that it connects with.

5 Q For example, a connection might be friendly to
6 me as a railroad if I as a railroad can deliver some
7 traffic to them that they can carry on to destination,
8 that they wouldn't get otherwise? That would make them
9 friendly?

10 A That's right.

11 Q Back in the good old days when we had the
12 Applicants' opening statements under consideration here,
13 a fellow named Mr. John J. Schmidt in SFSP 12 on page 3
14 said, when he was talking about the Burlington Northern
15 merger, he said: "When the Burlington Northern merger
16 was completed in November 1980, our expectations began
17 to be fulfilled. ATSF has lost valuable north-south
18 movements of grain and lost its friendly connection with
19 the Frisco at Avard, Oklahoma, ATSF's most effective
20 access to expanding markets in the southeastern United
21 States."

22 Do you agree with your chairman, Mr. Schmidt,
23 that the Santa Fe lost valuable north-south movements of
24 grain from the Burlington Northern?

25 A Yes.

1 Q Do you agree that it lost a friendly
2 connection with the Frisco at Avarad?

3 A Oh, to some extent. We still participate in a
4 movement with the Burlington Northern from Avarad, but
5 it's size has decreased substantially.

6 Q And was that friendly connection your most
7 effective access to the expanding markets in the
8 southeastern United States, as Mr. Schmidt said?

9 A Yes.

10 Q On page 5 of Mr. Schmidt's statement, he said
11 that: "Because of the Union Pacific rail consolidation
12 with the Missouri Pacific, major segments of Santa Fe's
13 and Southern Pacific's business are now vulnerable to
14 the substantial power of the new Union Pacific system."

15 Do you agree with that?

16 A I certainly do.

17 Q Now, was the Union Pacific merger a blow to
18 the Southern Pacific also?

19 A I'm sure it was.

20 Q Did they lose friendly connections?

21 A They lost the Union Pacific at Ogden for one,
22 and I'm sure they lost others.

23 Q Both the Santa Fe and the Southern Pacific
24 told the Commission that these traffic losses and loss
25 of friendly connections would happen, did they not?

1 A I'm sure they did.

2 Q Is the Central Corridor different in behavior
3 of shippers and carriers from the Southern Corridor?

4 A I think it is a little different, but it's a
5 difference of degree. I think our general notion -- and
6 it's really nothing more than a notion -- is that
7 because of the more mountainous terrain in the Central
8 Corridor, there is somewhat less pervasive truck
9 competition than there is in the Southern Corridor.

10 There's no shortage of it, to be sure.

11 Q Let's see if we can shorten down some of the
12 examination on counsel's exhibits MKT-C-64, 65, 66, and
13 67.

14 A Okay.

15 Q In 64, 65, 66, and 67, I have attempted, Mr.
16 Fitzgerald, first to extract the positions of these
17 companies and the arguments of these companies as to the
18 proper market to be looked at.

19 Will you agree that both the Santa Fe and the
20 Southern Pacific urged the Commission to look at
21 railroad freight transportation as the market to be
22 looked at in the UP-MP merger?

23 MR. NELSON: I want to renew my objection
24 because Mr. Fitzgerald would have to start looking
25 through those documents to see it.

1 MR. KHARASCH: If you like, I will point you
2 to --

3 JUDGE HOPKINS: Why don't you point to the
4 specific ones? I'll allow it.

5 BY MR. KHARASCH: (Resuming)

6 Q All right. Let's start with 64.

7 JUDGE HOPKINS: If Mr. Fitzgerald knows
8 generally, then there's no sense in our going through
9 each of the specific ones.

10 BY MR. KHARASCH: (Resuming)

11 Q I start at page Roman I-35 in MKT-C-64 in
12 which the Santa Fe brief says railroad freight
13 transportation is the proper product market in which the
14 competitive effects of these transactions should be
15 analyzed.

16 A Okay.

17 Q Do you find it at page 35 of that section as
18 extracted?

19 A Yes.

20 Q Now, looking at that, do you agree or disagree
21 that railroad freight transportation is the proper
22 product market in which competitive effects should be
23 analyzed in this case here?

24 A In this case right here today?

25 Q Right here today.

1 A No. I don't agree.

2 Q That's wrong?

3 A That's wrong.

4 Q Even though the Santa Fe said it was in the UP
5 case?

6 A I don't know what the record was in the UP
7 case.

8 Q I see. And will you accept, by looking at
9 MKT-C-66, at page -- in this case it is Roman III-9 --
10 the Southern Pacific began to argue that the appropriate
11 markets are railroad transportation of specific
12 commodities between individual origin and destination
13 points?

14 That was their position, was it not?

15 A That's what the Southern Pacific argued in the
16 UP-Missouri Pacific-Western Pacific merger; yes.

17 Q And you disagreed with that?

18 A I do disagree with it.

19 Q And does the SFSP disagree with that?

20 A Yes, it does.

21 Q But is it not true, Mr. Fitzgerald, that the
22 Commission said, you know, this is right and we will
23 consider rail-to-rail transportation as the appropriate
24 market in which to measure competitive impacts.

25 A I don't know. If the Commission did, I think

1 the Commission was wrong.

2 Q I see. So the Santa Fe argument was wrong and
3 the SP argument was wrong and the Commission is wrong.

4 A Well, that's the premise on which you asked
5 the question. It certainly would not be correct to do
6 so in this case.

7 Q Has there been any change in law -- and you
8 are a lawyer, so perhaps you could answer this -- has
9 there been any change in law since the date of the
10 Commission's decision in this case?

11 A In the Union Pacific case? I'm not aware of a
12 change in the law.

13 Q Has there been a change in railroad market
14 share between 1982 and 1984 generally?

15 A Yes. It's declined.

16 Q Is that so? What's the source of that?
17 What's the source of your statement that it's declined?

18 A Personal knowledge.

19 Q According to figures from Transportation
20 Policy Associates -- transportation in America -- which
21 are the figures that are published in the statistical
22 extract of the United States, the railroad market share
23 between 1982 and '84 went from 36 percent to 36.6
24 percent.

25 Do you have different figures, or does your

1 gut tell you --

2 A I do have some different figures.

3 Q Where would your figures come from?

4 A DRI.

5 Q DRI?

6 A Data Resource Institute.

7 Q You think Data Resource's figures are more
8 reliable than the Transportation Policy Associates?

9 A I don't know anything about Transportation PA,
10 whatever it is. I do know that the fact there has been
11 a decline in rail market share squares with my personal
12 experience. I know that we have lost major segments of
13 our business to highway.

14 Now, perhaps if you are measuring it on some
15 sort of a ton-mile basis or something like that, in
16 which unit coal trains can make up for great quantities
17 of much more remunerative traffic, I would have no basis
18 for disagreeing with the data that you're talking
19 about. But in terms of dollar value of transportation,
20 there has been a considerable change from 1982 to 1985.
21 And it has been in the direction of trucks gaining and
22 rails losing.

23 Q Did you know when you were writing your
24 statement or approving someone writing your statement in
25 this case, that a different position as to the

1 appropriate market for measuring competition had been
2 taken in the UP-MP case? Did you know that?

3 A I'm sure I was aware of it.

4 Q You were aware of it?

5 A Yes.

6 Q And you were aware that the Southern Pacific
7 had also taken a different position, or not?

8 A That's the way these cases are fought out, Mr.
9 Kharasch. I guess it all depends on what side you're
10 on. But you won't see me having testified in any manner
11 contrary to the way I'm testifying today.

12 Q Now, suppose Mr. Cena had testified contrary
13 to the manner that you are testifying today. Then you
14 would just say Mr. Cena was cutting his cloth to fit the
15 case he was testifying in?

16 A Perhaps.

17 MR. NELSON: I would like to again renew my
18 objection to this line of questions. We have pleadings
19 in different cases not participated in by Mr.
20 Fitzgerald, based upon an entirely different record.

21 JUDGE HOPKINS: Well, he's asking his opinion,
22 really.

23 MR. KHARASCH: And I'm attempting to show
24 that --

25 JUDGE HOPKINS: I'm allowing the questions.

1 Go ahead.

2 MR. KHARASCH: I think the strength and belief
3 to be accorded to the position depends on whether it's
4 been consistent.

5 JUDGE HOPKINS: Go ahead.

6 BY MR. KHARASCH: (Resuming)

7 Q Would you agree, looking at page I-82 of
8 MKT-C-64, where we have an admiring quote from Santa Fe
9 president Cena -- do you see in the middle of the page
10 that quote?

11 Just above that block quote, it says:
12 "Wherever the new Union Pacific system has available a
13 long haul route reasonably adequate to handle a
14 movement, Union Pacific can be expected to take the
15 pricing and contracting actions necessary to draw the
16 movement away from other railroads and to its new system
17 routes."

18 Now, do you agree that Union Pacific (a) could
19 be expected to do that; and (b), do you agree that it
20 has done that?

21 A I don't know whether it could have been
22 expected to do it at the time. I just don't know one
23 way or the other. There are certainly instances where
24 it has done it -- San Antonio coal movement being the
25 most recent.

1 Q Can the SFSP be expected to take the pricing
2 and contracting actions necessary to draw movements away
3 from other railroads into the new SFSP system?

4 A Where the new single line would be more
5 efficient, yes.

6 Q And can it be expected to draw the movements,
7 regardless of efficiency, where you have available a
8 long haul route reasonably adequate to handle the
9 movement?

10 A I don't think so.

11 Q It would only be if the movement was efficient
12 that you would draw it away?

13 A Yes.

14 Q And does efficiency, as you have just used the
15 word, mean anything specific, or is it as vague as
16 efficiency means in your policy in your SFSP-C-2?

17 A I don't think it's vague at all. But it does
18 also include, as I mentioned just a little bit ago,
19 shipper profits. You take, for example, the movement of
20 Ford automobiles from Kansas City to Houston, where
21 today we could handle those on a single line basis.

22 Because of Ford's interest in keeping your
23 railroad in the route, we agreed to short haul ourselves
24 in Seeley, Texas, handling only Seeley to Houston, and
25 giving your railroad the lion's share of the revenue.

1 That's an example, if you will, of shipper
2 leverage. It's also an example of our willingness to do
3 what the customer is interested in, and I don't think
4 that's going to change one bit after the merger.

5 Q So it would be efficiency as modified by
6 shipper preference.

7 A That's the reason I told you earlier on, I
8 don't think that you can come up with a formula which is
9 going to handle every case. And that's the reason we
10 said in this route and rate policy, the rate decisions
11 are going to be handled on a case-by-case basis. That's
12 the only way I know how to do it.

13 It would be nice if we could put it all on the
14 computer and have the answer spit out, but that's not
15 the way it works.

16 Q Look at MKT-C-65. I'm looking at page 50 of
17 this reply brief of the Santa Fe, where I see a vigorous
18 argument that the Union Pacific's economic self-interest
19 would cause it to compete vigorously for a shipment by
20 its new long haul route, despite the fact that its costs
21 might be higher than the cost via Sweetwater which was a
22 junction of a joint route.

23 Do you see that argument?

24 A Yes.

25 Q Do you know that argument? Do you agree with

1 it?

2 A I certainly know the argument. It's kind of,
3 I guess, the classic argument in these cases.

4 Q It was being made by the Santa Fe. Do you
5 agree with it?

6 A I don't agree with it, no. And I'll tell you
7 why. It assumes that --

8 Q You don't have to tell me why.

9 MR. NELSON: Let the witness finish.

10 JUDGE HOPKINS: If you want to, go ahead.

11 THE WITNESS: It assumes that the divisions
12 were fixed, and in my judgment divisions are negotiable
13 now with deregulation. And that's what's the matter
14 with it.

15 BY MR. KHARASCH: (Resuming)

16 Q That's an interesting point I wanted to raise
17 with you. Do you remember the rat tail example that was
18 discussed?

19 A Yes.

20 Q Shall we draw one? Do you have a blank piece
21 of paper there? Draw point A.

22 A That's Mr. Tye's example.

23 Q Draw point A which is at one end of the
24 movement, and then you draw an A to B on the left and an
25 A to B on the right, representing railroad 1 on the left

1 and railroad 2 on the right.

2 A All right, sir.

3 Q And then from B to C, you have just the tail
4 -- one railroad.

5 A Okay.

6 Q That's the rat tail.

7 A Right.

8 Q Now, the railroad that operates from B to C is
9 the only way by rail to get from B to C in our
10 assumption; correct?

11 A Yes.

12 Q The railroad that operates from B to C could
13 say to railroad 1, I'll make a rate with you to A, but i
14 expect you to take a rather low division.

15 Is that what you're talking about when you're
16 talking about divisions?

17 A Yes.

18 Q And it could say to railroad 2, (a) I could
19 use railroad 1; why don't you, railroad 2, take a low
20 division?

21 A It could.

22 Q Does your railroad take kindly to being
23 jockeyed around on divisions like that?

24 A It's part of the environment today, and it
25 happens all the time.

1 Q Do you bid yourself down to variable cost to
2 get traffic as a policy?

3 A Not as a policy.

4 Q You referred in your statement to Mr.
5 Bosanko's and Mr. Reyff's statement as sort of
6 introducing -- master of ceremonies.

7 A That's right.

8 Q Mr. Bosanko and Mr. Reyff used the phrase
9 "competition directly by rail or indirectly by
10 rail/truck."

11 Would you agree with their usage that
12 rail/motor or rail/water competition is sort of indirect
13 competition with straight rail movement? Is that good
14 usage?

15 A Well, I don't really mean to speak for Mr.
16 Bosanko and Mr. Reyff, but as I would understand the
17 context of your question, competition by any mode is
18 direct.

19 Q You wouldn't call it indirect if it's
20 rail/truck or rail/water?

21 A No. It's probably just a question of
22 semantics, but it's no less competition because it comes
23 from another mode. It no less directly impinges on
24 you.

25 Q Well, I'm not sure I'm illuminated by the

1 usage.

2 A Me either.

3 Q Let's get to the question I wanted to ask
4 anyway, which is: Isn't it true in the context you seem
5 to be using it, that the Santa Fe today has the ability
6 to compete indirectly to all Southern Pacific points and
7 ports and water crossings today?

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1 A As I would understand your question, the
2 answer is yes. To some extent, everyone who offers a
3 freight transportation service is to some extent either
4 an actual or a potential competitor with everybody else
5 who does that.

6 Q And that is either joint line rail, or you
7 could get there by rail and then truck.

8 A Yes. Barge.

9 Q Or rail and barge in some instances?

10 A Yes.

11 Q You could do that?

12 A Yes.

13 Q But it seems to be better, if I understand
14 your testimony, it seems to be better to be able to give
15 single line rail service than it is to give this sort of
16 two-step service, truck/rail or truck/barge.

17 A It certainly is in terms of the ability of the
18 railroads to be able to attract business which otherwise
19 is going to move on another mode; yes.

20 Q And is it not true, doesn't it affect the
21 ability of a railroad to compete with another single
22 line railroad such as the UP?

23 A I'm sorry. Now I have lost the focus.

24 Q You said in your last answer that it is good
25 for the ability of the railroad to compete with other

1 modes to have direct single line service.

2 A Yes.

3 Q And is it not also good for a railroad's
4 ability to compete with other railroads to have single
5 line service?

6 A Yes.

7 Q Indeed, is not that one of the points that Mr.
8 Schmidt and Mr. McNear was making when they described
9 the need for the merger, that you find the Union Pacific
10 has that sort of single line ability and you don't?

11 A Yes.

12 Q And do you think other railroads than your
13 railroad are in the same position of meeting the ability
14 to compete single line in order to compete?

15 A Yes. I think that's one of the principal
16 things behind the merger movement, the ability to access
17 more markets; that would sort of be on the revenue
18 side. And on the cost side it would be the ability to
19 capture the advantages of single line service.

20 Q Does your principle that it is not rational
21 for a railroad to cancel efficient routes mean that all
22 the joint routes today are the most efficient?

23 MR. NELSON: Where was the testimony that it's
24 not rational? Are you referring to an earlier answer?
25 Something in writing?

1 BY MR. KHARASCH: (Resuming)

2 Q Is it the thrust of your testimony and Santa
3 Fe's position in this case that it wouldn't be rational
4 for a railroad to cancel an efficient joint route?

5 A Yes, that's right. It wouldn't be rational.

6 Q It would not be rational. So that means that
7 the joint routes that we have in place today are the
8 most efficient routes?

9 A I didn't say that. There are a lot of joint
10 routes that are left over from the much more stringent
11 regulation of routes and rates by this Commission. I
12 think the industry is in a period of transition with
13 respect to routes and rates in the light of the Staggers
14 Act, and that's ongoing.

15 And various manifestations of that include the
16 route closing activity which took place several years
17 ago and then the renegotiation of reciprocal switching
18 agreements and renegotiation of divisions and so on.

19 And all of that is, I think, part of an
20 ongoing process to adapt the railroad industry to the
21 post-Staggers deregulated era.

22 Q Do you think the Santa Fe's connections with
23 the Union Pacific were inefficient routes?

24 A Some were and some weren't.

25 Q Let's take something specific because I'm

1 really baffled by this. We have between Kansas City and
2 Houston today, there is a Santa Fe direct line, is there
3 not?

4 A Yes, sir.

5 Q And there is also a joint line service between
6 Kansas City and Houston, between the MKT and the
7 Southern Pacific; correct? It connects at Denison,
8 Texas.

9 A Yes.

10 Q That's actually the shortest route in mileage,
11 isn't it?

12 A I don't know. Yes, sir. It would also be the
13 Union Pacific direct.

14 Q Let's just take those two between the Santa Fe
15 and the SP-Katy together. If a joint line service is
16 able to survive in this market and carry substantial --
17 in this case, grain -- does that indicate that the joint
18 line route is probably the most efficient route, or just
19 that the single line people don't feel like lowering
20 their price, or what?

21 A It could mean either.

22 Q It could be either?

23 A Sure.

24 Q What about railroad pricing behavior in that
25 circumstance where you've got a joint line competing

1 with a single line? Does the single line route come
2 snug up against the joint line route if it is competing,
3 or how does it price itself usually?

4 A I don't think that there is a general answer
5 that lends itself to that question. I think railroad
6 pricing behavior for whatever its other virtues may be,
7 is awfully eclectic. And I don't believe it's possible
8 to state a general rule as to who is going to be higher
9 and who is lower.

10 You know, there's another joint line route in
11 that city pair that I just mentioned to you that you
12 didn't use, and that is Santa Fe. Katy-Santa Fe.

13 So part of the problem with the premise of
14 your question is that you isolate two competitors, two
15 rail competitors in a world that's full of other
16 competitors. And I guess my overall experience is that
17 the single line as against the joint line are probably
18 paying less attention to what the other is doing than
19 both of them are as to what the barge line that calls on
20 Kanas City is doing for instance.

21 I guess you were not in the room when Mr.
22 Coburn from Continental Grain testified. But he
23 testified specifically with respect to the grain
24 movements that you're talking to me about now, and he
25 said that water makes the rates between Kansas City and

1 the Gulf, and that is certainly our experience.

2 Q And then you have to price from an origin
3 served by rail so that your price is less than the truck
4 to water or the rail to water?

5 A Exactly.

6 Q And the water down.

7 A Exactly.

8 Q And you price snug up against those rates?

9 A As snug as you can get.

10 Q Leaving as little on the table as possible.

11 A That's what they pay us for.

12 Q Let's drop the water out. Let's just talk
13 about a market in which there are two railroads.

14 A I'd like to drop them out, you know,
15 altogether.

16 Q Let's talk about someplace where it's nice and
17 dry.

18 A Good.

19 Q We have two railroads operating.

20 A Maybe you could tell me where that is.

21 Q Well, let's say one railroad has -- I'd like
22 to take it theoretically for a moment, and you could
23 tell me why that market is appropriate.

24 We have two railroads and one railroad has on
25 it, let's say, an \$8 cost. And defined the same way

1 between the two same city pairs, there's another
2 railroad with a \$9 cost on the route.

3 And let's assume for the moment that we don't
4 have water competition and let's assume it's liquified
5 argone gas that can't move by truck; okay?

6 Now, what's the price going to be in that
7 market? Do you know? Can you make a prediction,
8 practically, as a practical traffic? Is the price going
9 to be \$8, \$9, \$10?

10 A Maybe it's going to be \$8.99.

11 Q It could be \$8.99?

12 A You have to understand that the information
13 flow in the railroad business is a long way from perfect
14 in terms of pricmaking, who's a price maker, who's a
15 price taker.

16 You know, shippers will allege they have
17 options that they don't have. And then, just about the
18 time that you think they're bluffing, they'll take one.
19 But in a purely theoretical world, if I were the guy
20 with the \$8 cost, I would price my service at \$8.99.
21 But it's not a perfect world.

22 Q And then you would take all the business at
23 \$8.99?

24 A Sure.

25 Q Now, let's talk about the real world. Does

1 that happen in the real world?

2 A I've never seen it.

3 Q Does the fact that there are just two
4 carriers, let's say two railroads in a particular rail
5 market -- let's say in this case this \$8 or \$9 are below
6 the truck costs in this market. Does the fact that
7 there are just two railroads in the market mean that
8 they wouldn't necessarily both be dealing at \$11, \$10.50
9 or something like that?

10 A I've never seen that.

11 Q Why is that?

12 A Avarice, stupidity, maybe even the law.

13 Q So if one guy's cost is \$8, and one railroad's
14 cost is \$9, they're not likely to go to \$11?

15 A No. There is absolutely no quarter given and
16 none asked in railroad marketing. And again, understand
17 that I only give that answer in the theoretical context,
18 that I don't know where on this planet that situation of
19 only two rail players with no source competition, no
20 product substitutibility or any of those other things
21 might come into play.

22 Q Now, you have raised that point in your
23 testimony about source competition. Let me just get one
24 thing clear. Let's say that the price in Houston of
25 grain is \$4 a bushel for wheat. I'll just pick that.

1 It's a little better than it is, I believe.

2 A I think you're right.

3 Q Let's say \$4 a bushel. Now, up here in a
4 grain growing state, there is someone who's not on the
5 water, but he has to sell his grain. Now, he can't do
6 much about that \$4 price in Houston because there's
7 Argentine grain and Brazilian grain, and there's grain
8 from other sources.

9 This grain grower up there in the Middle West,
10 he can't affect that price very much. That's the market
11 at the moment; right?

12 A That's absolutely right.

13 Q Now, of that \$4, though, that will be the
14 price of a bushel of grain there, the \$4 price may be
15 divided. It might be \$1 for transportation, and \$3 for
16 the farmer, and it might be \$1.50 for transportation and
17 \$2.50 for the farmer; right?

18 A Yes.

19 Q So although there is source competition for
20 wheat in Houston, that doesn't dictate necessarily the
21 division between the shipper's price and the
22 transporter's price.

23 A No. Not that in and of itself. But, you
24 know, the farmer has a variable cost of growing grain.
25 Your railroad and my railroad and the barge line have a

1 variable cost of moving the product. And it may very
2 well be that under those circumstances you can get grain
3 to Houston for four bucks, in which case the grain comes
4 in from Argentina.

5 Q If the variable cost of growing grain plus the
6 variable cost of moving it to Houston is greater than
7 \$4, it ain't going to move from that particular source
8 we're talking about.

9 A That's right.

10 Q Indeed, that sort of allocation back and forth
11 makes for the most efficient markets.

12 A Yes.

13 Q Page 20, toward the end of your statement --
14 and you'll be happy to know I'm getting toward the end
15 -- you start talking about operating problems and
16 inefficiencies and increased costs.

17 A Yes, sir.

18 Q All these terrible things will happen from
19 grant of the trackage rights.

20 Let's take them separately. Had you have a
21 chance to hear Mr. Kenefick's testimony in this case or
22 read it?

23 A No, I'm sorry.

24 Q Assume then, please, for this, for the purpose
25 of the question, that Mr. Kenefick said that the Union

1 Pacific/Missour Pacific case trackage rights have been
2 implemented and are working all right without any
3 operating problems that he knows of. Assume that.

4 Do you have any information that says Mr.
5 Kenefick is wrong?

6 A No.

7 Q And insofar as you have looked at the future
8 pattern of the SFSP if it is allowed to merge, you don't
9 know of any reason that that would be wrong either, as
10 far as operating?

11 A Well, Mr. Kenefick didn't get a whole lot of
12 trackage rights imposed on him. He got Denver and Rio
13 Grande between Pueblo and Kansas City, actually over our
14 line for the first few miles, and that's a secondary
15 main line for the Union Pacific.

16 And he got the Southern Pacific between Kansas
17 City and St. Louis which I assume might create some
18 greater degree of difficulty.

19 Nothing on the order, the magnitude, or the
20 scope of the trackage rights that are being sought
21 here.

22 Q Gee, you forgot the MKT's trackage rights.

23 A Oh, yes. I imagine that probably didn't
24 create them too much difficulty.

25 Q Have you had any problems in Santa Fe?

1 A Since we didn't get any --

2 Q Have you any problem with the trackage rights
3 or, in your case, terminal access that was granted?

4 A I don't know.

5 Q Are there many examples, in fact, in industry
6 of railroad-to-railroad cooperation in joint facilities
7 or using facilities jointly?

8 A Yes. And I would hope it would continue to
9 increase. I think it's going to have to. That's
10 fundamentally different from marketing extensions,
11 though.

12 Q Now, you mentioned in your testimony on page
13 20, you mention operating problems, inefficiencies, and
14 increased costs. Those are the three you've mentioned,
15 but I don't see you mentioning the existence of
16 competition.

17 That doesn't bother you -- the existence of
18 trackage competition, another railroad competing?

19 A On the contrary, that's one of the things that
20 I do talk about in here. The fact that a competitor, a
21 competitor would be granted access to my physical
22 properties and then subsidized by the stockholders or by
23 the shippers because the trackage rights compensation
24 was not at full value places my company potentially in a
25 disastrous position from a competitive standpoint vis a

1 vis that other rail competitor.

2 He's going to have lower costs than I do.

3 Q So you want to be sure that the competitor has
4 the same costs as your company?

5 A I want to be sure that the competitor pays the
6 same going-in cost that my company has paid all along.

7 Q Not the variable cost?

8 A No, sir.

9 Q The going-in cost.

10 A The full cost.

11 Q That's the historic book cost?

12 A No, sir; that's replacement cost.

13 Q Replacement cost, new. You want him to pay
14 that, sharing it with you if he shares the line?

15 A That's right.

16 Q On a use basis?

17 A That's right.

18 Q Do you just want a cash payment? If it's
19 going to cost you \$100 million, and he's going to use 10
20 percent, would he pay \$10 million, something like that?

21 A We put our money up front.

22 Q Do you know if the Commission has ever priced
23 trackage rights that way?

24 A I don't think it has.

25 Q When you negotiate for use of some rights over

1 someone else's track, do you pay that way?

2 A When you negotiate freely for use of railroad
3 of another, you do pay that essentially because what you
4 do is in some fashion or other, you reciprocate. There
5 is no reciprocity behind the imposition of trackage
6 rights.

7 Q You are concerned that full payment be made
8 and you are concerned with operating problems,
9 inefficiencies, increased costs and you want your
10 competitor to make a full payment for the track. But
11 you're not concerned that someone is competing with you,
12 getting the ability to compete?

13 A Not if they pay the full cost; no, sir.

14 Q The full cost is replacement cost of the
15 line.

16 A Yes, sir.

17 Q Now, suppose the line is not being used much
18 today.

19 A That's another reason why you shouldn't have
20 trackage rights in the first place. If there's not
21 enough density to warrant one railroad doing well out
22 there, why have two?

23 Q But I'm thinking, for example, that one
24 railroad is getting between the two -- getting to market
25 over one line and it has another duplicating line. How

1 does hurt to give that duplicating line to a
2 competitor? And I'm thinking specifically, why
3 shouldn't the Katy get to Mexico over a line that the
4 Southern Pacific is using once every other day?

5 A I wouldn't have any problem with that if they
6 pay the appropriate cost.

7 Q We're talking about the line from San Antonio
8 to Spofford, let's say. It's being used by the Southern
9 Pacific once every other day.

10 What's the appropriate price the Katy should
11 pay for that?

12 A They want you to correct the record.

13 Q San Antonio to Sinton. I said Spofford. I
14 mean Sinton.

15 A While I was picking up Sinton, I was losing
16 your question.

17 Q Think of a line from San Antonio to Sinton.
18 That is one of the lines that the Katy wants because it
19 wants access to Mexico so it could have single line
20 service to Mexico. Single line service is a good
21 thing. We want to get to Mexico.

22 The Southern Pacific is not using that line to
23 Sinton except once a day.

24 A It's not using it very much.

25 Q That's right.

1 A When you get to Sinton, how are you going to
2 get to Mexico single line? It's not single line.

3 Q The connection is from Sinton via the Tex Mex,
4 the same as the Southern Pacific.

5 A You understand my problem. I don't understand
6 how that gets MKT to Mexico single line. You just
7 mentioned the Tex Mex.

8 Q I beg your pardon. It will get it to Sinton
9 by only a two-line connection with the Tex Mex.

10 A Why don't you interline with the Union Pacific
11 at San Antonio and save yourself that circuitry? That's
12 what I would do.

13 Q That's what you'd do, but now we want to talk
14 about the price that the Southern Pacific should extract
15 so it's not un[airly treated for the use of this line
16 that it uses once every other day southbound and once
17 every other day northbound.

18 What's that price that you say must be
19 charged?

20 A The replacement cost.

21 Q New?

22 A New.

23 Q In terms of operating over that line, it's not
24 going to hurt the Southern Pacific for us to operate
25 over a line used once every other day, is it?

1 A I'd like to defer to Mr. Simpson on that. I
2 think you'll find some testimony to that effect.

3 Q Was that particular access to Mexico in your
4 mind when you were thinking about operating problems?

5 A No more so than any of the others.

6 Q Or inefficiencies or increased costs?

7 A No. As I say, I read Mr. Simpson's
8 statement. I agree the line is not very densely used.
9 The biggest problem I have is trying to understand why
10 the Katy would want to go in such a circuitous fashion
11 to get to Laredo, when in fact you can tie in and do
12 your two-line haul to Laredo directly to San Antonio
13 with the Union Pacific.

14 Q Maybe it's easier -- although you're not
15 examining me, I'll give you the answer -- that maybe
16 it's easier to do business with the Tex Mex than the
17 Union Pacific.

18 A That's a shame. When you wind up being
19 acquired by them, I trust that will improve.

20 Q What I really imagine will happen, Mr. Witness
21 -- and this is just a comment, Your Honor -- what I
22 really imagine will happen is the Commission will
23 obviously deny this merger, and then the Southern
24 Pacific will make an inconsistent application if there
25 is any such business.

1 JUDGE HOPKINS: Very interesting.

2 BY MR. KHARASCH: (Resuming)

3 Q Let's go to voluntary rights, the idea that
4 the way people should get trackage rights is by
5 voluntary negotiation.

6 A In the marketplace.

7 Q How are you doing on getting trackage rights
8 rights to Memphis?

9 A I don't know that we're trying to get trackage
10 rights to Memphis, are we?

11 Q In MKT-C-64, at page 76, we find the Santa Fe
12 lamenting at the top of the page, that you would have to
13 compete with Union Pacific single line system between
14 Memphis and New Orleans gateways without having single
15 line ratemaking capability.

16 Has the Santa Fe not tried to get operating
17 rights to Memphis, trackage rights to Memphis?

18 A Never tried to get trackage rights there. At
19 one point we considered buying the Sunbelt Line of the
20 Chicago Rock Island & Pacific from the Trustee in
21 bankruptcy, which would have had that effect.

22 Q At the moment we were talking about making
23 voluntary trackage rights acquisitions. Why have you
24 not tried to make a voluntary trackage rights
25 acquisition to Memphis?

1 A I assume we understand that in the bargaining
2 sale, the price would have been higher than we could
3 afford to pay.

4 Q You couldn't make a profit at the price that
5 would be extracted from it, so there's no use paying
6 that kind of price?

7 A That's right.

8 Q Have you had any involvement in making
9 presentations to the United States Department of
10 Transportation or other U.S. departments in connection
11 with this case?

12 A No.

13 Q Is there some group within the Santa Fe or
14 within the Southern Pacific or a joint SFSP group that
15 coordinates such presentations?

16 A I don't know.

17 Q Have you had anything to do with any
18 discussions with the U.S. Department of Transportation
19 or presentations to the DOT on the subject of Conrail
20 and the sale of Conrail?

21 A No.

22 Q Or the position of Santa Fe on Conrail, or the
23 SFSP on the Conrail sale?

24 A No. Our position on that is still in a state
25 of formation. I suppose we'd better hurry.

1 Q Now, you have warned us and I think I have
2 seen a story in which Mr. Schmidt delivered warnings
3 that if too many conditions are granted here, this
4 consolidation isn't going through.

5 A I don't want to term it a warning. And in
6 fact, I think I said it wasn't a threat and it isn't a
7 threat; it's simply a statement that this merger, as we
8 understand it, cannot be burdened with much in the way
9 of conditions in order for this merged carrier to have a
10 realistic chance of surviving.

11 That's not a threat. That's just how it is.

12 Q Now, I wish you to, if you would please,
13 cleanse your mind of all conditions requested except
14 those of the MKT. Is it a deal breaker that the MKT
15 should be allowed access to Mexico?

16 A I don't know.

17 Q You just don't know whether it's going to
18 cause you to throw up your hands at the whole merger if
19 MKT gets to operate every other day? I mean on a line
20 used every other day by the Southern Pacific?

21 A I don't know that that, standing by itself,
22 would cause the deal to fall through. But what I am
23 saying to you is that really the more important
24 consideration from the standpoint of whether to go ahead
25 or not is what is going to be the condition of the

1 carriers on the date that the merger is ultimately
2 approved and allowed to go forward.

3 Their condition is deteriorating. It's
4 deteriorating rapidly. If there is a recession in the
5 next year, I'm not sure that there's going to be enough
6 in the Southern Pacific left to warrant Santa Fe going
7 forward under any circumstances.

8 But my understanding is that Mr. Schmidt has
9 testified that we would go ahead with the merger if no
10 conditions other than the labor conditions were
11 imposed. Now, what I'm saying to you is, if the company
12 reached the conclusion that except for Mr. Schmidt's
13 commitment we would not go ahead, if the Commission came
14 up with some condition or other, we might well choose to
15 use the fact of the imposition of a condition to abort
16 the merger.

17 I don't know that. But, you know, those are
18 the kinds of things that concern me very much.

19 Q That's very interesting and I guess I
20 understand your concern. But I really want to focus on
21 this Mexico condition.

22 If the Southern Pacific is in the same shape
23 it is today, do you consider that allowing the Katy to
24 get access to Mexico is going to abort the deal if
25 nothing else but that if offered?

1 A You really mean getting access to the Tex Mex,
2 don't you?

3 Q To the Tex Mex; exactly.

4 A I would say that, standing alone, that would
5 not cause the deal to blow up. That would be my
6 opinion. It would be my vote.

7 Q And if we look at the request for access to
8 the Liberal line to serve the grain shippers there,
9 would that cause it to blow up?

10 A You know, at this point there's not enough
11 grain out there for one railroad, much less two. You
12 know, we have seen grain absolutely dry up as a
13 commodity.

14 Q I wish you'd answer my question. Would it
15 cause the deal to blow up? If there's no grain, I
16 assume it's not going to make the deal blow up.

17 A This week it certainly wouldn't make one bit
18 of difference. But down the road, we'd have to look at
19 it then.

20 Q And then let's look at the Bayport line.
21 Let's consider the Bayport line. Bayport is 2.3 miles
22 -- accept this; this is my information -- 2.3 miles from
23 the PTRA limits, switching limits.

24 Do you think allowing the Katy to get over
25 those 2.3 miles and serve Bayport is going to abort this

1 merger?

2 A I don't know.

3 Q You don't know on that one?

4 A I don't understand the theory on which Katy
5 wants to get over there either.

6 Q We're not going to discuss the theory at the
7 moment. My questions are directed to what is a deal
8 breaker.

9 A I don't know.

10 Q You don't know about that one.

11 How about the vast city of Midlothian? Do you
12 think that's a deal breaker?

13 A I don't think it would be, standing alone.

14 Q An access to Beaumont? The Katy having access
15 to Beaumont?

16 A I have read Mr. Simpson's testimony about what
17 a confusing situation that would pose. But again,
18 standing alone, I'd vote that we go ahead if we were to
19 make that choice today.

20 Q Do you have any idea of how much traffic the
21 Southern Pacific conditions placed on the UP drew away
22 from the UP?

23 A No.

24 Q You have been inspecting as potential chief of
25 SFSP the traffic patterns in both the SP and the Santa

1 Feb

2 A I've been trying to, to a lesser extent with
3 respect to the SP because of the terms of the trust, you
4 understand.

5 Q But you have a fairly good idea of what the SP
6 is carrying between Kansas City and St. Louis?

7 A No.

8 Q You don't?

9 A No.

10 Q So that had better be addressed to an SP
11 traffic officer?

12 A I think Mr. Bosanko would be appropriate.

13 Q I'll try Mr. Bosanko. Thank you, Mr.

14 Fitzgerald.

15 JUDGE HOPKINS: Is that all.

16 MR. KHARASCH: Yes.

17 JUDGE HOPKINS: Before we take -- well, I
18 don't know whether we'll take a recess.

19 How much longer would there be of the other
20 parties?

21 MR. LEARY: I'll be well within the half hour
22 asked for, Your Honor.

23 JUDGE HOPKINS: Department of Justice,
24 Department of Transportation?

25 MS. KOOPERSTEIN: Department of Justice has

1 no questions.

2 JUDGE HOPKINS: Department of Transportation?

3 MS. REED: Maybe one or two, Your Honor.

4 JUDGE HOPKINS: Why don't we go ahead then.
5 now? What about the Applicants? I'm wondering, do you
6 think you'll have any redirect?

7 MR. NELSON: Oh, not at this point.

8 JUDGE HOPKINS: Why don't we take a 15-minute
9 break?

10 (Recess.)

11 JUDGE HOPKINS: Let's get back on the record.

12 Mr. Leary.

13 BY MR. LEARY:

14 Q Mr. Fitzgerald, my name is Tom Leary. I
15 represent the Rio Grande Railroad. Can you hear me over
16 here?

17 A Yes, sir.

18 Q I'm going to try not to repeat anything that's
19 been asked before, and if I do inadvertently, I
20 apologize. But I'll try very hard to avoid that.

21 Would you turn to page 7, please, at the top
22 where you make the statement about four lines down that
23 the receiver may prefer truck movements because of
24 greater flexibility of schedules or because it does not
25 have storage capacity.

1 A Yes.

2 Q Are there not some shippers who already have
3 installed substantial facilities for receiving bulk
4 shipments by rail?

5 A Yes, sure.

6 Q And might not those shippers prefer rail
7 shipments -- receivers, excuse me.

8 A Yes. I think that's one of the things that
9 tends to hold traffic that has historically moved
10 rail-to-rail is the capital investment that shippers and
11 consignees have made in terms of being able to make
12 deliveries or take deliveries.

13 Q Is it fair to say that different shippers have
14 different needs, do they not?

15 A That's fair to say.

16 Q On page 9, you had extensive discussions with
17 Mr. Kharasch about working with competitors on an
18 interline route if the route was more efficient.

19 Just a few questions on that. You've
20 testified, have you not, that you compete with the
21 Southern Pacific in many areas today?

22 A Yes.

23 Q Do you have substantial interchanges to or
24 from the Southern Pacific today?

25 A At some points.

1 Q At some points?

2 A Yes.

3 Q Is that roughly the same order of -- level of
4 cooperation that a competitor could expect from the SFSP
5 after this merger?

6 A Well, you skipped a step there. There's
7 nothing the matter with the cooperation between the
8 Santa Fe and the Southern Pacific where we have
9 substantial interchanges. And I would envision that
10 that would be the same level of cooperation which we
11 would extend to other carriers after the merger; yes.

12 Q You expect the interchanges to be at roughly
13 the same level on a relative basis?

14 A You mean in terms of volume?

15 Q Yes.

16 A Well, we have premised that rail diversions to
17 our line would approximate \$200 million. And to the
18 extent that those diversions are off of our connecting
19 carriers, that would cause a decrease in the volume of
20 business moving to and from our connections in that
21 sum.

22 So we are forecasting a decline in interchange
23 traffic because of the efficiencies of the single line
24 haul.

25 Q Do you regard the interline connections that

1 you presently have with the Southern Pacific today as
2 having a potential for achieving end-to-end efficiencies
3 to a greater degree than you have already?

4 A Yes.

5 Q Do you believe that any of those efficiencies
6 could be achieved by means short of merger?

7 A Oh, perhaps, but they would be modest at
8 best. We might in some corridor or other be able to
9 pool power and run through locomotives and so on. But
10 it would not be anything in a major kind of a way in a
11 total reformulation of the entire traffic base, and then
12 sorting that out by the most efficient way of handling
13 it.

14 Q Would you turn now to page 11, please? You
15 make the statement in the end of the first full
16 paragraph: "In my judgment, any view of the market that
17 omits our truck and water carrier competitors is simply
18 untenable."

19 A Yes.

20 Q Are you familiar with the criteria for
21 defining markets that are set forth in the Department of
22 Justice merger guidelines?

23 A I really am not. I have read a couple of
24 verified statements that deal with them, but I just have
25 no -- no.

1 Q At the bottom of page 12, you make a statement
2 that: "Assuming there might be some possibilities to
3 increase rates by small amounts, if they exist they
4 would fall far short of the kind of market power which
5 would enable us to recover anything like our current
6 total cost of service."

7 And I notice that you cite the verified
8 statement of Professor Baumol there. Is that correct?

9 A Yes, sir.

10 Q Do you understand Baumol to be saying in his
11 testimony that there's no economic reason for concern
12 about a merger which might enhance market power, so long
13 as the firms are not earning their cost of capital?

14 A Yes, that's what I do understand him to be
15 saying. And while I don't have any problem with that
16 just in terms of an economic point of view, my purpose
17 here is to tell the Commission and anyone else who's
18 interested that that's strictly a theoretical problem
19 because as a practical matter, we're not going to be
20 able to exercise, in my judgment, any increased market
21 power; that is to say, raise prices any as a result of
22 this merger.

23 Q Is your understanding that economic returns,
24 as an economist uses the phrase, is the same as
25 accounting returns that show up in a financial

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1 statement?

2 A No, I think those are two different things.

3 Q On this question of market power and rate of
4 return, turn back to page 5, if you will, please, at the
5 top of the page there, where you talk about the two
6 different scenarios.

7 A Yes.

8 Q Is it your understanding that the Applicants
9 or the railroads protesting this application are making
10 the claim that the Santa Fe and the Southern Pacific
11 have market power today?

12 A No. The purpose in this paragraph is to
13 suggest that if there were compartmentalized, segregated
14 markets in which there was only a couple of railroads
15 competing against no one else, that through some sort of
16 oligopolistic behavior, a duopoly if you will, the two
17 of us would have substantial market power.

18 And the suggestion that I am trying to make
19 here is that going from two railroads to one railroad,
20 that is to say, going from a duopoly to a monopoly,
21 would not change anything fundamental about the external
22 environment in which we operate which has so many other
23 players.

24 I'm not sure I said that right, but the point
25 I'm making is that two railroads, if they were in a

1 segregated, compartmentalized market, would have
2 substantial market power. In fact, these two railroads
3 do not have substantial market power. The reason must
4 be that there is substantial other competition from
5 other modes.

6 Q Is it your testimony that economic theory
7 suggests very little difference between two competitors
8 and one competitor in a market?

9 A I think it's a difference of degree; yes.

10 Q Is it your testimony that the earnings record
11 of these two companies is inconsistent with a finding of
12 market power in any market?

13 A The current earnings performance of these two
14 companies is totally inconsistent with anything
15 resembling substantial market power.

16 Q Do you believe it's impossible for a
17 revenue-inadequate company to have market power in any
18 market?

19 A No. I think it's possible.

20 Q Do you think it's unlikely?

21 A I think it's unlikely that it would have it in
22 a substantial number of markets, but it could have it in
23 one or the other.

24 Q You testified earlier on, didn't you, that it
25 was your understanding of Mr. Koehn and Mr. Strangle's

1 testimony that they estimate it would require an overall
2 rate increase of 30 percent to make the merged entity
3 revenue-adequate?

4 Do you remember that?

5 A I remember it, but you haven't stated it quite
6 correctly. I think it's on page 76 of the verified
7 statement, and what they're talking about is Santa Fe
8 standing alone in order to become revenue-adequate would
9 require a 30 percent increase in all of its rates.

10 Q And you testified, I believe, that that's
11 highly unlikely in prognostication, in your opinion. Is
12 that correct?

13 A I think it's impossible.

14 Q Suppose, just for the sake of argument, that
15 Santa Fe were able to raise rates by 10 percent on the
16 average overall after the merger. Would that be
17 evidence of some market power?

18 A Yes, it would.

19 Q And yet Santa Fe would still be
20 revenue-inadequate, would it not?

21 A That's right. And that's the entire purpose
22 of my comments at the middle of page 12, is to say that
23 regardless of the theoretical underpinnings of Baumol
24 and the economists, I don't know of a single instance
25 where we would have enhanced market power as a result of

1 the merger.

2 Q You don't know of a single instance where you
3 would have enhanced earnings as a result of the merger
4 or enhanced market power?

5 A Market power. I would think that we would
6 have some increased earnings.

7 Q I thought you just agreed that with a 10
8 percent increase in rates, your railroad would have
9 enhanced market power, but it still would have
10 inadequate earnings.

11 A And I don't see anything inconsistent there.
12 Maybe you can explain to me what you find inconsistent
13 about it. The increased earnings is going to come about
14 from decreased costs, not increased rates.

15 Q Oh, I'm sorry. You didn't understand my
16 hypothetical. Let me go back.

17 The hypothetical was that it would require a
18 30 percent increase in rates overall to achieve revenue
19 adequacy. Is that correct?

20 A Well, it's your hypothetical.

21 Q I'm taking it from the two economists on whom
22 you rely.

23 MR. MARTIN: It says in excess of 30 percent.

24 BY MR. LEARY: (Resuming)

25 Q In excess; right. And you said that kind of

1 rate increase is highly unlikely; isn't that right?

2 A I said it's impossible.

3 Q And I am saying that you could have a rate
4 increase -- hypothetically, you might have a rate
5 increase of 10 percent; is that right?

6 A If you say so. Hypothetically, you could have
7 a rate increase of 10 percent.

8 Q Hypothetically, if you had a rate increase of
9 10 percent, would that indicate market power?

10 A Yes.

11 Q And you would still be revenue-inadequate;
12 right?

13 A Right.

14 Q So a revenue-inadequate carrier can still have
15 market power; is that right?

16 A Yes. Market power is anything, any ability
17 you may have to charge rates above your variable cost.
18 We have some market power now because we charge some
19 rates over and above our variable costs.

20 Q Technically, it's not variable cost, is it?

21 A Well, I don't know. It is in my book.

22 Q We'll get there with Dr. Baumol tomorrow.

23 A Okay, good.

24 Q Page 15, toward the bottom of the page, you
25 say: "But to the extent, if any, that the merger

1 somehow created or enhanced the merged carrier's ability
2 to increase its rates, that ability would be constrained
3 by our preservation of existing joint rates," in a
4 parenthetical, "(and also by the Commission's ability to
5 prevent cancellation of those rates.)"

6 Is that right?

7 A Yes, sir.

8 Q Do you regard those as two separate
9 constraints on your ability to increase rates?

10 A Yes.

11 Q Do you regard it as a constraint on your
12 ability to raise rates if you choose to preserve your
13 exiting joint rates? Is that a constraint on you?

14 A The two constraints of which I'm speaking are
15 SFSP-C-2 and the Ex Parte 456 proceeding along with the
16 Commission's general jurisdiction in the area of rates
17 and routes.

18 I see those as being complementary but not
19 necessarily identical. And that's the reason I said
20 that there aren't two separate reasons; yes.

21 Q You have said earlier, have you not, that a
22 Commission proceeding is a somewhat less than ideal way
23 to constrain rates, haven't you?

24 A To what?

25 Q To constrain rates.

1 A I would find it so. I didn't used to when I
2 was a lawyer.

3 Q Have you, as an executive of Santa Fe, availed
4 yourself of that procedure in extremis from time to
5 time?

6 A Yes.

7 Q With what outcome?

8 A We lost.

9 Q Turn now to page 21. I have one final
10 question here.

11 You refer to losses, "that these merger
12 benefits and savings not be diluted substantially
13 through the burdens, costs, and traffic losses that
14 would be associated with grants of trackage rights."

15 Do you see that?

16 A Yes, sir.

17 Q When you refer to trackage losses, are you
18 referring to losses from a premerger level of traffic or
19 losses from the diversions that you have predicted as a
20 result of the merger without conditions?

21 A It doesn't matter to me. Either way. Whether
22 you take our separate traffic bases, add the two of them
23 together, and then add in the \$200 million of traffic to
24 be diverted as we posit it, and take the traffic losses
25 either from that figure or the figure before you add the

1 200 to it, in either event, based on my understanding of
2 the testimony of the responsive Applicants, that would
3 be a very substantial figure in the aggregate.

4 Q Is it your understanding that you would wind
5 up with a net loss of traffic overall on a premerger
6 basis?

7 A If you simply add up the diversion estimates
8 of the responsive Applicants, that would be the case;
9 yes.

10 MR. LEARY: Thank you.

11 JUDGE HOPKINS: Mr. White.

12 MR. WHITE: Your Honor, I have only one
13 question. May I ask it from here?

14 JUDGE HOPKINS: Go right ahead.

15 BY MR. WHITE:

16 Q Mr. Fitzgerald, following up on Mr. Kharasch's
17 question, would you view trackage rights awarded to the
18 Tex Mex, standing alone, from Sinton to San Antonio to
19 be a deal stopper?

20 A Again, today, without regard to what may
21 transpire between now and the merger date, I would
22 certainly hope not.

23 MR. WHITE: Thank you, Your Honor.

24 JUDGE HOPKINS: Ms. Reed.

25 MS. REED: Just one moment, Your Honor.

1 (Pause.)

2 (Discussion off the record.)

3 MR. KHARASCH: Your Honor, in our
4 off-the-record discussion, I indicated because of the
5 illegibility and unavailability of copies of the
6 Commission's decisions, that I think it might be useful
7 to have in the record as an exhibit for identification
8 the decision in finance docket 30568, Southern Pacific
9 Transportation petition, and ask that that be marked as
10 MKT-C-68.

11 JUDGE HOPKINS: That will be marked for
12 identification as MKT-C-68.

13 (The document referred to
14 was marked Exhibit MKT-C-68
15 for identification.)

16 MR. KHARASCH: And I will offer in evidence
17 MKT-C-62 through 67.

18 JUDGE HOPKINS: Why don't we wait till Ms.
19 Reed has questioned, in case they have something
20 further?

21 Ms. Reed.

22 BY MS. REED:

23 Q Good afternoon, Mr. Fitzgerald. My name is
24 Mary Reed and I'm with the Department of Transportation.
25 I just have a few questions.

1 A Yes, ma'am.

2 Q On page 9 of your verified statement in the
3 second full paragraph, you refer to the SPSF joint route
4 and rate policy statement that has been identified as
5 SFSP-C-2. And you discussed it in some detail today.

6 Would the SFSP be willing to accept as a
7 condition of merger the imposition of this rate policy?

8 A Sure.

9 Q Now, I take it from the answers that you have
10 given today that this would not mean that the SFSP would
11 be guaranteeing equal rates on a joint line move as it
12 could offer on a single line haul.

13 Is that correct?

14 A That's right. I think our experience,
15 particularly with the Union Pacific merger, is that
16 rates go down after a merger. And specifically they go
17 down in new single line service, and I would anticipate
18 that's going to happen with respect to our merger.

19 You know, we're not going to guarantee,
20 similarly, that the joint routes would also go down
21 because the efficiencies would really only come where
22 new single line service becomes possible.

23 Q So what guarantees would you be willing to
24 make as far as the joint rates, if any?

25 A I think that the sense in which the AAR-NIT

1 League agreement is complementary to and comes into play
2 in this area is that if this becomes part of the CFR, if
3 the ICC finds that it solves the competitive access
4 problem, that all joint rates that are in effect on the
5 date of the merger would continue in effect unless and
6 until a party to the joint rate were to come in and for
7 some reason or other attempt to cancel that rate.

8 At that point, as I testified in response to
9 Mr. Auerbach's questions this morning, either a shipper
10 or a connecting carrier, feeling aggrieved, can come
11 before the Commission and attempt to have the
12 cancellation of the rates suspended and investigated.

13 It would be through the investigative process
14 by the Commission that the parties claiming to be
15 aggrieved would have the opportunity to present evidence
16 that in fact the cancellation of the rate was
17 anticompetitive. And if the Commission found that to be
18 the case, the Commission could and would deny the
19 authority to cancel the rate.

20 That has, I think, the additional advantage
21 from our point of view of bringing stability to the
22 railroad industry which we at Santa Fe have long fought
23 to get in this area of rates and routes, and haven't
24 been terribly successful.

25 As I just answered Mr. Leary's question, we

1 were unsuccessful in getting route cancellations stopped
2 by the Commission earlier, and this would give both
3 carriers and shippers a much easier time in getting that
4 stopped.

5 Q How would you maintain existing or efficient
6 service via existing gateways?

7 A As I said in my last appearance, we would
8 continue to maintain service that was commensurate with
9 use levels by the customer. If you start with the
10 premise that we're going to be adopting divisional
11 levels and rates, joint rates that are in effect the day
12 before the merger, on the date of the merger, you have a
13 basis for beginning.

14 And as I say on page 15 of my statement,
15 that's exactly what we do. And any deviation therefrom
16 would be on the basis of our perceiving a need to make
17 some change and subject to the rights of the public, the
18 shippers, and the carriers to come before the ICC and
19 say that there was some anticompetitive behavior
20 involved.

21 I'm not suggesting that there would be any.
22 I'm simply saying that I believe that the public and the
23 various constituencies represented here would be
24 adequately protected by this provision.

25 Q In response to a question by the DRGW, you

1 indicated that a 10 percent increase in rates, even
2 though it would not enable the SFSP to achieve revenue
3 adequacy, would indicate market power.

4 Is that correct?

5 A Yes, as I understand those terms. And
6 apparently Mr. Leary and I may not understand then the
7 same.

8 Q Wouldn't it be true, however, that a 100
9 percent increase in rates would not necessarily indicate
10 an abuse or undue market power?

11 A That's my point. It would not be an undue
12 abuse, and that's the reason that I wrote the statement
13 the way I did. My only point in bringing the matter up
14 at all in a practical vein, rather than simply leaving
15 it to the economists to argue about, is to want to urge
16 on you that this merger is not going to give us the
17 ability to increase rates, to my knowledge, anywhere at
18 all.

19 Q Wouldn't it also be important to know what the
20 existing rate level was for a particular movement?

21 A Certainly it would.

22 Q For example, if the rates on a movement had a
23 revenue-to-variable-cost-ratio of 100 percent, a 10
24 percent increase in rates would not be an exercise of
25 undue market power; correct?

1 A On the contrary, it would be necessary, at
2 least as we do our costs, to just begin to cover a share
3 of fixed costs.

4 MS. REED: Thank you. That's all I have.

5 JUDGE HOPKINS: Mr. Nelson.

6 MR. NELSON: No redirect, Your Honor.

7 JUDGE HOPKINS: You're excused, sir.

8 MR. KHARASCH: I'll offer in evidence MKT-62,
9 63, 64, 65, 66, and 67.

10 JUDGE HOPKINS: Any objections other than what
11 has been stated previously? Any objection?

12 MR. NELSON: No. No objection to the
13 admission.

14 JUDGE HOPKINS: They will be received in
15 evidence.

16 (The documents referred to,
17 previously marked Exhibits
18 MKT-C-62 through 67 for
19 identification, were
20 received in evidence.)

21 MR. NELSON: I move the admission of Mr.
22 Fitzgerald's statement.

23 JUDGE HOPKINS: Any objection? His testimony
24 will be received in evidence.

25 We'll be in recess until 9:00 o'clock tomorrow

1 morning.

2 (Whereupon, at 4:10 o'clock p.m. the hearing
3 recessed, to reconvene at 9:00 o'clock a.m., the
4 following day, Wednesday April 10, 1985.)

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