BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

COMMENTS OF UNION PACIFIC RAILROAD COMPANY

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Union Pacific Railroad Company offers these comments in response to the Surface Transportation Board's Notice served January 11, 2011, in this proceeding.[1] Union Pacific urges readers to review the accompanying verified statements of James R. Young, Chairman, President, and Chief Executive Officer of Union Pacific Corporation and Union Pacific Railroad Company, and Lance M. Fritz, Executive Vice President - Operations for Union Pacific Railroad Company. Union Pacific also endorses the comments submitted by the Association of American Railroads.

Part I of these comments introduces the critical issues raised by the prospect of regulatory change that would give shippers control over access to Union Pacific's assets and the ability to override Union Pacific's transportation plans. Part II summarizes the testimony of Union Pacific's witnesses, who describe (a) how the Staggers Act and the regulatory policies that followed produced increased investment and higher levels of service for shippers, and (b) how changing the Board's competition policies would undermine those accomplishments, reducing

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[1] In a decision served February 4, 2011, the Board extended the procedural schedule established by the Notice.

investment and driving down service levels. Part III addresses whether consolidation of the rail industry provides any reason to change the Board's competition policies.

I. INTRODUCTION

Union Pacific opposes any change to the competition policies that have made possible the railroad industry's remarkable recovery and resurgence since Congress enacted the Staggers Act in 1980. The policies adopted by the Interstate Commerce Commission and the Board have benefited shippers, railroads, and the public. Following Congress's direction, the ICC and the Board freed railroads to respond to market forces and become stronger, more agile competitors while protecting shippers against abuse of market power. Importantly, the agencies permitted railroads to discontinue inefficient routes and interchanges, allowing them to increase traffic density, which in turn drives efficiency, service, and investment. The resulting transformation of the U.S. railroad industry proves the wisdom of that approach.

Union Pacific has never run a safer or more efficient network than it does today. In 2010, our reportable personal injury and rail equipment incident rates were at record low levels, and our Service Delivery Index and Customer Satisfaction Index were at record high levels.

Union Pacific achieved these results by investing billions of dollars in our network since the Staggers Act, including almost $30 billion since 1999. These were market-driven investments, made in response to shipper demands for more and better rail service. We built our network and designed our transportation plans to route traffic via the most efficient routes, with the fewest interruptions. We were able to invest in such a network because our shareholders and capital markets believed that we would be allowed the opportunity to earn market-based returns. As we invested, our performance improved, our revenues increased, and we were able to invest even more in our network.

Our work is not done. We must continue investing if we are to meet customer expectations as traffic volumes rise. Our 2011 capital budget of $3.2 billion is the largest in our history. Union Pacific has publicly told investors to expect us to expand capital investment to keep pace with revenues in coming years, unless the rules governing our industry change.

If the Board were to adopt rules imposing reciprocal switching or trackage rights arrangements on railroads ("forced access") or rules requiring railroads to interchange traffic at points designated by shippers ("forced interchange"), we would curtail investments in our network. We would have less revenue to invest, and our shareholders would demand that we cut our capital budgets. Moreover, forced access and forced interchange are not just regulatory theories; they would change how rail cars move and wreck efficient networks. If shippers could require us to use inefficient routes and interchange points, our past investments would become less productive, and service would be disrupted, with the potential for serious service meltdowns. While regulatory changes favored by a small group of shippers might produce lower rates for those shippers, the ultimate effect would be to harm all rail shippers. As Mr. Young explains, the Board "has little margin for error here." Young V.S. at 4.

II. UNION PACIFIC'S EXPERIENCE SHOWS THAT THE STAGGERS ACT IS A PUBLIC POLICY SUCCESS, BUT REGULATORY CHANGE COULD DISMANTLE OUR ACHIEVEMENTS.

Union Pacific is proving that the Staggers Act is a public policy success, despite service difficulties we experienced at earlier points. The statements of Messrs. Young and Fritz explain how the Staggers Act and the Board's current access policies have been essential foundations for the best-ever levels of safety and service we are now providing, and how changing those policies would put safety and service at risk. We summarize their testimony below.

A. The Impact of Access Policies on Union Pacific's Financial Condition and Capital Investments (Mr. Young's Verified Statement)

The Staggers Act granted railroads the freedom and flexibility to rationalize their networks and improve their economic condition. As Mr. Young explains, Union Pacific was able to invest to improve service "because our shareholders and the capital markets believed we would have the opportunity to earn market-based returns." Young V.S. at 8.

As Union Pacific's earnings increased after the Staggers Act, the company invested more in its network, and it ramped up investments in recent years. Between 1999 and 2010, the railroad devoted approximately $30 billion to capital expenditures, with investment levels generally tracking freight revenue trends. *See id.* Union Pacific plans to invest a record $3.2 billion in 2011 to renew current assets, improve service, and accommodate growth. *See id.* at 9. It also plans to invest in coming years at 17 to 18 percent of revenues, "the economy and regulation permitting." *Id.* at 10.

However, if the Board "changes the regulatory landscape in a way that curtails Union Pacific's opportunity to earn market-based rates of return on investment, we will reduce our capital investments." *Id.* at 4. As Mr. Young explains, proposals to change the Board's access policies are designed to reduce rail revenues. This will roil investors: "If the Board signals that it is no longer committed to allowing railroads to operate under market conditions, our shareholders will demand that we curtail capital investment." *Id.* at 3. If investors do not see the prospect of market-based returns from rail investments, they will take their investment dollars elsewhere. "Investors withdrew private investment in the past, due to ill-advised regulation, and they will again." *Id.* at 4.

Moreover, routing uncertainty would undermine our ability to invest. Forced access and forced interchange would make it "increasingly difficult to predict which lines, yards,

and interchanges will be used in the future and therefore should be investment priorities." *Id.* at 15. "[I]f shippers can decide to move traffic to less efficient routes that they may use only briefly or for which they will pay only artificially low access fees, we cannot justify investing." *Id.* at 14. We would also have "little or no incentive to invest in an asset that a competitor can use at a regulated, bargain price." *Id.*

B. The Impact of Access Policies on Union Pacific's Safety and Service (Mr. Fritz's Verified Statement)

The limited access policies put in place to carry out the Staggers Act allowed Union Pacific to tailor its capital investments and transportation plans to develop better, more efficient, and safer services. Mr. Fritz describes how Union Pacific achieved our best-ever safety and service results by aligning "our capital spending with our basic operating strategy of concentrating traffic where possible on higher-capacity, higher-density corridors." Fritz V.S. at 5. He explains that the Board's existing access rules played a critical role by allowing us to "coordinat[e] our investment and transportation plans," which "improved the efficiency and predictability of our network." *Id.* at 4. This allowed us to maximize efficiency and minimize transit times and to take advantage of "single-line service benefits," benefits the Board has repeatedly recognized. *Id.*[2] Mr. Fritz also provides examples of the extensive capital investments we have made to improve service and safety, and the additional investments we plan to make if the regulatory environment does not change in a way that reduces investment incentives and threatens our ability to provide efficient service. *See id.*, Appendices A & B.

The regulatory changes some shippers interests have proposed present such a threat. Mr. Fritz states that "[f]orced access and forced interchange are fundamentally

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[2] See the cases cited below on page 9.

incompatible with reliable service and improving safety on our network." *Id.* at 17. As he explains:

"Shipper-dictated access and interchange decisions would disrupt operations on our lines and in terminals. They would force traffic over facilities that were not designed to handle the business and reduce the productivity of the ones in which we have invested. The immediate result could be a service meltdown in major terminals." *Id.* at 17-18. As we learned during the service crisis following the Southern Pacific merger, and "as we saw again in the traffic surge in the middle of the last decade, problems on one part of the railroad network quickly spread to the rest of the network." *Id.* at 18.

Even if we avoid short-term service collapse, "forced access and forced interchange would make our entire network less efficient because traffic would be diverted from the most efficient routes, reducing densities on those routes and thus unraveling the efficiencies that Union Pacific has built over decades." *Id.* at 24. Such measures "would also undermine our past and future capital investments." *Id.* at 26. They "would require us to spend more to provide the same level of service, would strand investments that we previously made based on expectations that traffic flows would follow efficiency principles, not regulatory principles, and would make future investments more risky, and therefore less likely." *Id.*

III. CONSOLIDATION IN THE CLASS I RAILROAD SECTOR DOES NOT PROVIDE A REASON TO CHANGE THE BOARD'S ACCESS POLICIES.

Union Pacific strongly disagrees with the suggestion in the Board's Notice that changes to access policies might be justified because of "increased consolidation in the Class I railroad sector." Notice at 3. In fact, rail mergers have increased competition. They provide no reason to explore "possible policy alternatives to facilitate more competition." *Id.* at 1.

Those who lament the decline in the number of Class I railroads since 1980 wrongly equate the number of railroads with the strength of competition.[3] The ICC made the same mistake in the pre-Staggers Act era. As a result, the rail industry was highly balkanized in that period. Multiple railroads were often needed to move traffic from origin to destination, with each interchange adding costs and delay. When railroads were allowed to consolidate, neither they nor shippers could benefit from most efficiencies associated with single-line service because the ICC imposed conditions on mergers that prohibited the new carrier from offering reduced rates or improved service that would result in the "commercial closing" of interline routes or gateways. *See Traffic Protective Conditions*, 366 I.C.C. 112, 112-13 (1982). The ICC was concerned that if shippers flocked to the more attractive service offerings, "competition would be reduced." *Id.* at 113. As a result, railroads declined and went bankrupt.

Post-Staggers Act rail mergers helped transform a balkanized industry into efficient rail systems that compete vigorously against other modes and against each other. Thousands of shippers enthusiastically supported these mergers, recognizing that they would enhance competition by creating more single-line service, shorter routes, shorter transit times, lower costs, and many other efficiencies.[4] The ICC and the Board repeatedly acknowledged these pro-competitive features of rail mergers in their decisions approving the transactions. *See,*

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[3] As the Association of American Railroads observes in its Comments, those who play this numbers game typically ignore the actual number of pre-Staggers Act solvent, independent railroads with revenues that are comparable to today's Class I railroads. Many of the Class I railroads in 1980 were subsidiaries of others. *See* AAR Comments at 19 n.20.

[4] Some mergers even created entirely new rail-to-rail competition, as well as enhancing the ability of the merged carriers to compete against others. For example, Union Pacific's merger with Southern Pacific created new rail-to-rail competition in the Seattle-Los Angeles "I-5 Corridor" through a settlement that gave BNSF Railway a single-line route that it could use to compete with the new Union Pacific. *See Union Pacific/Southern Pacific Merger*, 1 S.T.B. 233, 564-65 (1996).

e.g., *CSX Corp. et al. – Control – Conrail Inc. et al.*, 3 S.T.B. 196, 333-38 (1998); *Union Pacific/Southern Pacific Merger*, 1 S.T.B. 233, 375-84, 564-69 (1996); *Burlington Northern et al. – Merger – Santa Fe Pacific et al.*, 10 I.C.C.2d 661, 733-38, 740-42 (1995). In fact, in every merger involving Union Pacific since 1980, the ICC or Board emphasized the benefits of single-line service and expected us to achieve them. *See Union Pacific – Control – Missouri Pacific; Western Pacific*, 366 I.C.C. 459, 489-93 (1982); *Union Pacific Corp. et al. – Control – MO-KS-TX R. Co. et al.*, 4 I.C.C.2d 409, 430-31 (1988); *Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. – Control – Chicago & North Western Transp. Co. and Chicago & North Western Ry.*, Finance Docket No. 32133, Decision No. 25 (ICC served Mar. 7, 1995) at 66-68; *Union Pacific/Southern Pacific Merger*, 1 S.T.B. at 381, 564-65. For three decades, Union Pacific has invested its capital to achieve the single-line-service benefits that the ICC and this Board (and a wide range of shippers) sought; forced access and forced interchange are the enemies of single-line service and represent an entirely different and very damaging public policy.

The ICC and the Board carefully reviewed each merger and, where necessary, imposed conditions to ensure that no shipper would lose the benefit of rail-to-rail competition. *See Central Power & Light Co. v. S. Pac. Transp. Co.*, 1 S.T.B. 1059, 1071 n.18 (1986). Also, the Board has engaged in active oversight of recent Class I rail mergers and has acknowledged the pro-competitive outcomes of those mergers in its oversight decisions. *See*, *e.g.*, *Union Pacific/Southern Pacific Merger*, Finance Docket No. 32760 (Sub-No. 21), Decision No. 21

(STB served Dec. 20, 2001) at 3-5.[5] Rail mergers present no reason for the Board to reconsider its access policies.

IV. CONCLUSION

The Board's competition policies have allowed Union Pacific to invest the billions of dollars needed to provide safe and efficient rail service. Changing those policies would undermine our past accomplishments and future ability to invest, placing safety and service at risk.

Respectfully submitted,

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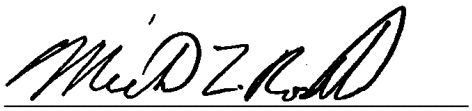

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[5] Independent studies have validated these pro-competitive benefits. *See, e.g.*, Denis A. Breen, *The Union Pacific/Southern Pacific Rail Merger: A Retrospective on Merger Benefits*, Review of Network Economics, Sept. 2004, at 283.

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VERIFIED STATEMENT

OF

JAMES R. YOUNG

VERIFIED STATEMENT

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JAMES R. YOUNG

My name is Jim Young. I am Chairman, President, and Chief Executive Officer of Union Pacific Corporation and Union Pacific Railroad Company. I started my railroad career with Union Pacific in 1978. Before assuming my present positions, I held a variety of management positions, including Vice President – Re-engineering and Design and Vice President – Customer Service Planning and Quality of Union Pacific Railroad, and Chief Financial Officer of Union Pacific Corporation.

I witnessed first-hand how the regulatory reforms of the Staggers Rail Act freed Union Pacific and other railroads to respond to the marketplace as other companies do and provided incentives for railroads to invest in their networks. Union Pacific is using those freedoms well to serve our customers and to enhance the nation's transport infrastructure. With improving revenues, Union Pacific has invested nearly $30 billion in its rail network since 1999, helping us provide value to our customers in recent years with the best service in memory. If the Surface Transportation Board turns back the clock by layering new regulation on the rail industry, our investments and our accomplishments for customers will be in jeopardy. The "access" measures now under consideration would reduce rail investment and cripple the efficiency, service, and safety gains that regulatory reform delivered.

OVERVIEW

This proceeding raises the question whether regulatory reform should be reversed because it is succeeding. Railroads are emerging as the vigorous competitors Congress hoped

for when it passed the Staggers Act 30 years ago, and rail competition is stronger than ever. Union Pacific is a prime example. Lance Fritz, Union Pacific's Executive Vice President – Operations, explains in his statement that in the post-Staggers Act period Union Pacific greatly improved its network and today provides record levels of customer service and safety. In the past two years alone, we invested approximately $5 billion — despite the worst recession in 80 years — to improve and expand our network and service. This year we intend to invest well over $3 billion — a record — to further improve safety, productivity, and customer service, as well as to expand our network for traffic growth.

In the current regulatory environment, the rail industry has blossomed, moving from the depths of the pre-Staggers Act era to provide vibrant competition and a critical contribution to our nation's economic growth today. Board regulations provide effective remedies for shippers that believe their rates are too high or that a railroad is engaging in competitive abuses. This regulatory regime has been a tremendous success for shippers, railroad employees, and the public. We should not forget that most rail rates remain well below inflation-adjusted rates from 1980.

Apparently some believe, however, that instead of celebrating this public policy success, regulators should dismantle the achievement. The Board is now considering whether to change the rules to permit solely-served shippers to insist that a second railroad access their facilities ("forced access") or to dictate interchange of their traffic where they choose ("forced interchange"). The goal of those who advocate forced access and interchange is to reduce rates and transfer revenue from railroads to certain shippers.

If the Board signals that it is no longer committed to allowing railroads to operate under market conditions, our shareholders will demand that we curtail capital investment. As

Union Pacific has explained many times, while the Board has regulatory powers over railroads, it has no ability to govern the behavior of the financial markets. The financial markets will withdraw capital from the railroad industry if the government decides to artificially suppress rail revenues. The markets would also increase our cost of capital in terms of both higher borrowing costs and higher required equity returns.

We understand why shippers, reasonably enough, prefer lower prices (although many choose better service over lower rates). Most shippers may not understand, however, that these potential regulatory changes could devastate the rail network by imposing inefficient operations on rail carriers and degrading service to all shippers. The proposals would reduce our ability to invest and would make many investments uneconomic.

The Board has little margin for error here. If it changes the regulatory landscape in a way that curtails Union Pacific's opportunity to earn market-based rates of return on investment, we will reduce our capital investments. We are prepared to curtail investment this year, depending on the outcome of this proceeding. I do not say that to be belligerent or provocative. We will have no choice. Investors withdrew private investment in the past, due to ill-advised regulation, and they will again. That is the central message of the pre-Staggers Act era, and it remains true today.

Union Pacific is equally concerned about the effects of access regulation on network efficiency and customer service. Like other railroads, Union Pacific spent tens of billions to create a rail network out of its component railroads, a network designed to maximize efficient rail operations and customer service. If regulators or shippers can decide that traffic should move over different routes and interchanges, without regard to network efficiency or where we invested, rail service could be crippled. Shifting traffic to routes and facilities where

we have not invested could overwhelm infrastructure that was never designed for those volumes and strand investments we made to provide better service.

At Union Pacific, we know from hard experience what happens when traffic volume outstrips infrastructure, creating service meltdowns. The types of new access regulation the Board is now contemplating would splinter traffic densities that are essential foundations for high levels of customer service and could cause meltdowns in major terminals like Houston. Mr. Fritz describes these dangers in his statement.

As implemented by the Interstate Commerce Commission and the Board over the past 30 years, the Staggers Act has been a great success, providing a regulatory framework that allowed railroads to transform themselves into efficient, robust competitors. Now more than ever, as our country gradually emerges from a severe recession, we need strong, efficient railroads to keep economic recovery going. The Federal Railroad Administration recently concluded that freight railroad performance contributes importantly to U.S. competitiveness in a global economy.[1] It makes no sense to impose new regulation that will reduce incentives for rail investment. The Board must avoid adopting measures that would take us in the opposite direction from the one that has worked spectacularly well for three decades.

In the remainder of this statement, I will discuss the remarkable success of the Staggers Act and how proposals for forced access and forced interchange would reduce rail investment and hurt customer service. I will also explain why there is no justification for the Board to change course and open the railroad to new access.

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[1] U.S. Dept. of Transportation, Federal Railroad Administration, National Rail Plan: Moving Forward 14 (Sept. 2010) ("National Rail Plan").

I. THE POST-STAGGERS ACT REGULATORY REGIME IS A SUCCESS

A. Staggers Act Reforms Transformed Railroading and Gave Us the Opportunity to Grow Revenues and Investments

The Board must not lose sight of history's teachings. When I entered the railroad business in 1978, the rail industry was stagnant and mired in oppressive regulation. Railroads had little ability to respond to market conditions. Restrictive rules and misguided policies forced railroads to keep all routes open, with little ability to rationalize operations and consolidate traffic on more efficient routes. The result was a balkanized rail network, with the government propping up inefficient operations on marginal routes and over unnecessary interchanges — an outcome some propose to reinstate here.

Railroads could not earn adequate returns, and they therefore had little ability or incentive to invest in their networks. They deferred spending on infrastructure, causing even important rail lines to deteriorate. For example, Union Pacific's primary connection to Chicago, the Chicago & North Western, fell into disrepair, with one of the two tracks to Chicago under slow orders and the other surviving only on federal money. Union Pacific's Board of Directors saw little promise for the railroad business, given inadequate earnings and too much regulation. The Board of Directors also feared that the government might take over Union Pacific, just as it would soon assume responsibility for passenger service and most northeastern freight railroads. Reflecting that pessimism, Union Pacific's management created a holding company in 1969 so that it could invest in profitable non-railroad businesses, such as natural resources, without fear of nationalization. Even at Union Pacific, America's healthiest railroad at the time, money flowed out of railroading and into more promising ventures.

The Staggers Act and the regulatory regime that followed transformed the industry. Importantly, railroads gained the ability to rationalize their networks by abandoning

under-used track, eliminating inefficient routes, extending single-line movements, and consolidating traffic to produce higher densities and more efficient service. Railroads also gained rate flexibility, so they could price to meet competition. Contract rates took the place of general rate increase proceedings and rates set through rate bureaus. The regulatory environment under the Staggers Act recognized that railroads must price their services on the basis of demand if they are to make the expensive, private investments that railroading needed.

Our own experience echoed the industry's. Union Pacific rationalized its network, eliminated inefficient routes and interchanges, improved its infrastructure, and added capacity, allowing us to provide more valuable and efficient service. Lance Fritz's verified statement discusses some of these investments and improvements. Many of our investments and enhancements implemented the consolidations that the ICC and the Board approved and provided the predicted public benefits of those consolidations.[2] Beginning in 1982, we:

- integrated Union Pacific with Missouri Pacific and rebuilt the deteriorating Western Pacific;
- bankrolled CNW's build-in to the Southern Powder River Basin;
- rebuilt much of the Missouri-Kansas-Texas, which otherwise would have failed;
- acquired CNW and rebuilt its line to Chicago, as well as Iowa grain lines that CNW might have abandoned;

[2] The rhetoric in Washington about mergers reducing competition ignores the enormous benefits of the consolidations for shippers. Without mergers, for example, Southern Pacific, M-K-T, and probably CNW would have gone bankrupt and could not have afforded to rebuild their systems. No shipper lost competitive service as a result of the Union Pacific mergers, and the merged system is more competitive against trucks and BNSF. Mergers created new competition in the I-5 Corridor on the West Coast and for new shippers on over 4,000 miles of UP rail lines. The resulting Union Pacific provides better service, safer operations, and more technology than its components could have.

- added vast amounts of capacity to Union Pacific lines across Nebraska and Kansas, installing a 108-mile triple-track on the world's busiest freight corridor; and
- integrated our system with the Southern Pacific, upgrading its infrastructure and offering shippers more efficient single-line routes and other service improvements.

We were able to make these investments because our shareholders and the capital markets believed we would have the opportunity to earn market-based returns.

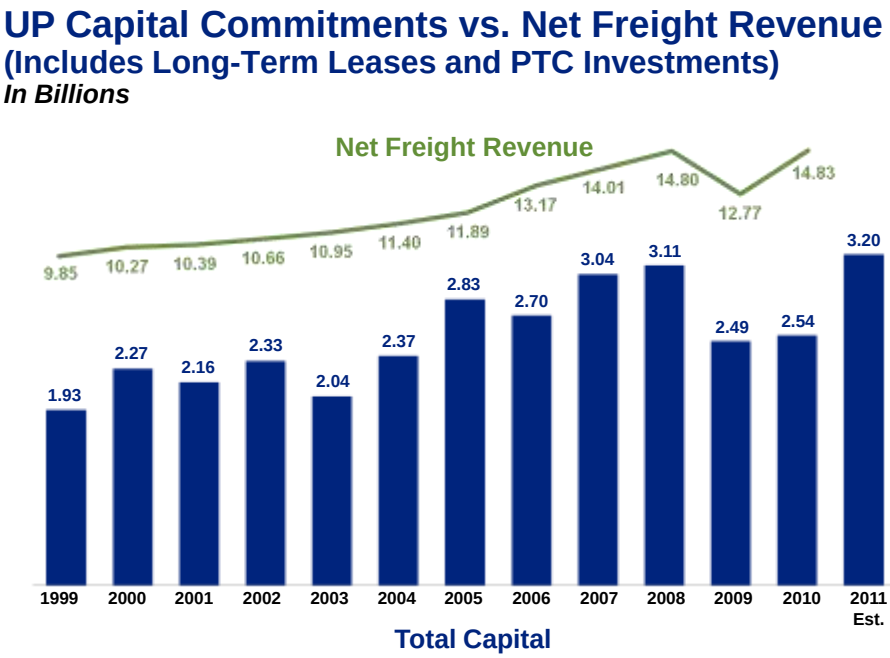
As our service improved, we attracted more business. Once Union Pacific's parent company began to see a good prospect of earning a competitive return from rail operations, it gradually spun off the non-transportation businesses it had turned to in the pre-Staggers Act period and refocused its attention on the railroad.

B. Our Improved Financial Condition Allows Us to Increase Capital Expenditures

Union Pacific's financial situation has improved gradually, but even now it is still not where it needs to be. The Board's measure of revenue adequacy is based on book value, and fails to account for the high replacement costs we must pay every day. Even using the Board's measure, however, Union Pacific's return on investment reached the cost of capital in only one year, 1995. Nevertheless, as our earnings increased in the post-Staggers Act period, we invested more in our system. We have continued to make large capital investments in our network, spending not only to restore and replace our system, but also to add new capacity (both track and equipment) to improve service and accommodate traffic growth.

As shown in the chart below, between 1999 and 2010 Union Pacific devoted approximately $30 billion to capital expenditures, with investment levels generally tracking freight revenue. This figure included nearly $10.3 billion in expansion capital (capital investments that increase Union Pacific's line or terminal capacity). Our total capital

expenditures for this period consumed 18 percent of our revenue (or 21 percent of revenue net of fuel surcharges). By comparison, the average U.S. manufacturer devoted about 3 percent of revenue to capital spending.



From 1999 to 2008, our capital expenditures grew by 63 percent, reaching a high of $3.1 billion in 2008. When the recession pummeled carloadings and our earnings fell, we pulled back on investment. It was prudent to preserve liquidity when there was widespread concern about the possibility of a double-dip recession. There was also no need to spend as much when, at the bottom of the recession, Union Pacific had as many as 2,100 locomotives and 71,000 freight cars in storage and enough line and terminal capacity to accommodate at least 50,000 more carloadings per week. Our capital spending remained robust, though, at around $2.5 billion annually during 2009 and 2010. As carloadings return and revenues grow, we plan to invest a record $3.2 billion in 2011. We have publicly told the investment community that we expect to continue to spend 17 to 18 percent of our growing revenues on capital investments for

the next several years, the economy and regulation permitting. In other words, we expect capital spending to keep pace with revenues.

Mr. Fritz's statement describes many of the capital projects we undertook in recent years to increase efficiency and improve service for our customers — projects we could fund because of growing revenues. We continue to identify new capital projects that will increase productivity, allow us to provide quality service for our customers, and expand our offerings. In addition, as Mr. Fritz's statement describes, we developed transportation plans and implemented new management processes to maximize productive use of our resources, reduce interruptions to shipments, and otherwise improve the value we bring to our customers.

These investments and improvements have paid off in important ways for our customers, our employees, and our investors. Mr. Fritz's statement describes the many ways in which the railroad's performance has improved in recent years, resulting in better service for our customers and higher levels of safety for our employees. In 2009 and 2010, we achieved all-time highs in our service delivery index (which measures the overall quality of our service), as well as record velocity levels, record reliability, reduced slow orders, and other service "bests." Our work force also set records for employee safety in 2009 and again in 2010.

I see the results of our capital investments and our other efforts to improve service in the high levels of customer satisfaction ratings we received in recent years. Our ratings on customer satisfaction surveys have risen to the highest level we have seen since we began conducting the surveys 20 years ago. In addition, when I speak with our customers one-on-one, they tell me how pleased they are with our performance and that our service levels have persuaded them to give us more business. Many focus on the additional value we provide because our service reduces their logistics costs or allows them to reach new markets or

suppliers. For me, this is the best evidence of how far we have come under the post-Staggers Act regulatory framework. But we cannot let our customers down again.

II. FORCED ACCESS AND FORCED INTERCHANGE WOULD REDUCE INVESTMENT AND SERVICE

Shipper groups calling for changes to the regulatory framework likely do not understand the consequences. Granting solely-served shippers the right to require a railroad to provide reciprocal switching and terminal trackage rights or to dictate interchange points would move the industry backward, both by artificially reducing rail revenues and by damaging efficient service. The Staggers Act allowed railroads to stop behaving inefficiently, but some want to turn the clock back to an era of poor service and poor performance.

A. Reduced Revenues Will Reduce Capital Investment

When I visit our customers, they applaud our capital investments and urge us to make sure that we will have capacity for their shipments in the future. To do this, we must first invest huge amounts of capital just to replace our existing assets. We constantly replace and upgrade rail, ties, bridges, and yard facilities and acquire or overhaul locomotives and cars. As Mr. Fritz's statement describes, we also have ambitious plans to handle anticipated traffic growth and provide additional value to customers. If the Board were to adopt broad forced access and forced interchange measures of the sort some shippers want, though, Union Pacific would reduce investment and would have much less incentive to invest in the future.

1. Expanded Regulation Would Reduce Rail Revenues

Advocates of forced access and interchange want the Board to change the rules so that Union Pacific and other railroads earn less. The result would be to leave us with less to invest in rail infrastructure. The purpose behind any forced access or forced interchange proposal is for solely-served shippers to pay less to move goods. Shippers advocating those

changes hope to reduce their rates, either by negotiating lower rates due to government-imposed "competition" or by bringing rate cases against "bottleneck" rates and obtaining rate prescriptions more favorable than they could obtain by challenging through rates. Another crucial ingredient of government-created "competition" is access fees set at artificially low levels, further depleting rail revenues. Without below-market access pricing, the artificial competition would not generate a large enough revenue transfer to satisfy proponents.

Meanwhile, railroad costs would increase, further depleting revenues. As Mr. Fritz explains in his statement, shippers are likely to make routing and access decisions favorable for them individually, but not for the rail network as a whole. Our unit costs would rise as we move backward toward pre-Staggers Act inefficiencies.

Rate compression and higher costs can result only in driving down revenues — a forced economic transfer by regulation. Proponents may claim that any lost revenue from the traffic Union Pacific loses could be made up by revenue on traffic diverted to us from other railroads. But shippers would not divert traffic to Union Pacific unless they would pay less in total, partly by avoiding payment of the market price for use of another railroad's assets. If the access option were truly more efficient, the two railroads would have offered a joint route or agreed to some type of joint facility already. The bottom line is that the proposals for forced access and forced interchange are aimed at having shippers pay less for transportation, in the face of added costs of hand-offs from one railroad to the other and of less efficient networks.

Rate increases for those shippers who have more options are not a solution. Shippers who do not wish to pay higher rates and who have alternatives, such as trucks or barges or a different source or product, will turn to those alternatives. We already have every incentive to price their traffic to maximize revenue without losing too much traffic. So we would have no

alternative but to reduce investment, and our rail franchise would shrink. We would serve fewer shippers and provide less service at the same time that the marketplace and government transportation authorities are telling us they want more freight on rail, not less.

2. Lower Returns on Investment and Less Cash Would Lead to Less Rail Investment

For both shareholders and lenders, it comes down to cash and returns. Our shareholders, and our lenders, want to know how much cash we are generating today, and, more importantly from their perspective, how much cash can they expect us to generate in the future. Our lenders want to know how likely we are to meet our future debt obligations on the money we borrow today. Our shareholders want to know if we will generate enough cash in the future to make us a good investment today. When they invest in our stock, they are taking an ownership position in our company. They expect us to generate enough cash going forward to increase the value of that ownership. We do this by spending wisely on growth capital opportunities that will improve our business and earn more in the future, and by running the company well enough to have some cash left over to return directly to them, i.e., a cash return.

Investors have the choice of investing in any public company or industry, and they assess the returns they can expect across their various investment alternatives in making that choice. Railroads already have a high cash hurdle because so much of the cash we generate must go back into capital expenditures. After including the other costs of running a business, such as labor and other operating costs, taxes, and pension contributions, the cash remaining for our shareholders is already relatively small. One measure investors consider is the excess cash generated as a percentage of a company's total assets. Cash returns on assets for other representative large industrial companies averaged about 6 percent in 2010, compared to 4.7 percent for Union Pacific. In recent years, our returns have been improving, which gives

investors hope that they can expect stronger returns in the future. Even with recent success in improving returns, however, our earnings do not generate enough cash to generate an adequate return for our owners when the high cost of replacing our assets is considered.

Investors watch closely for any changes that would reduce our future cash returns. Expanded regulation would directly impact our cash generation by driving down the revenue we earn, while at the same time increasing our operating costs through forced inefficiencies. With less cash available, our shareholders will insist that we reduce capital expenditures.

This is not idle speculation. Already, Wall Street analysts and our major shareholders are keeping a close eye on this proceeding. Analysts regularly discuss regulatory proposals and their likely effects on rail earnings. They ask us about regulatory developments during our quarterly conference calls and presentations. Our major shareholders tell us they are very concerned about any regulatory changes that will reduce our prospects for returns in the future.

3. Uncertainty About Returns on Individual Replacement and Capacity Projects Would Discourage Investment

Forced access and forced interchange options would increase the uncertainty that Union Pacific and other railroads face in considering each investment. This includes uncertainty about how much and where to invest in line capacity and terminals and how much to spend on replacing assets. We would have little or no incentive to invest in an asset that a competitor can use at a regulated, bargain price. And if shippers can decide to move traffic to less efficient routes that they may use only briefly or for which they will pay only artificially low access fees, we cannot justify investing.

In addition, we would face uncertainty about whether we would achieve projected cost savings from investments. Many capital projects are justified primarily because we expect

they will produce lower costs. Other projects pass muster only because the combination of anticipated revenue and cost savings allows them to exceed our hurdle rate. If shippers gain the ability to overrule our decisions on how to operate trains and to design service, our ability to estimate cost savings from investments will diminish.

If we cannot count on market-driven traffic flows or rates, we could not make rational decisions about where to invest in new capacity. We would find it increasingly difficult to predict which lines, yards, and interchanges will be used in the future and therefore should be investment priorities. Likewise, it would be more difficult to determine where to place more train crews to provide service for new reciprocal switches or interchange operations. Unless access prices were set at economically efficient levels (which advocates of more regulation oppose), forced access and interchange are investment killers.

4. The Public Interest Favors More Railroad Investment, Not Less

Adopting measures that would discourage rail investment would be poor public policy. Just a few years ago, a national commission reported on the urgent need for massive infrastructure investment in the United States, including investment to improve freight rail capacity.[3] The Federal Railroad Administration also stresses the need for more rail capacity.[4] Recently, the President emphasized the importance of new infrastructure investment in his State of the Union address. Infrastructure needs, including new construction to expand freight transportation capacity, are a national priority.

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[3] National Surface Transportation Policy and Revenue Study Commission, Transportation for Tomorrow, Vol. II, at 4-13 to 4-19 (Dec. 2007).

[4] National Rail Plan, at 6, 8-9.

As the Federal Railroad Administration reminds us, investment in freight railroads serves many vital interests.[5] Healthy freight railroads are important to the economic health of our nation and to the global competitiveness of U.S. companies. Putting more freight on the rails helps reduce highway congestion. Moreover, rail is a particularly fuel efficient form of transportation, so moving more freight by rail diminishes U.S. dependence on foreign oil. Rail also helps cut highway emissions, producing health benefits and reducing greenhouse gases.

The ongoing budget battles in Washington underscore the importance of encouraging private investment in rail infrastructure. A government that is borrowing 40 cents of every new dollar it spends will not increase, or even maintain, funding for subsidized trucks, barges, or air transport. Reducing rail investment would damage American competitiveness on the world stage and damage the U.S. economic recovery. Board actions that reduce investment incentives would hurt the nation for years, if not decades.

For all these reasons, the Board must avoid discouraging investment in railroads. The access measures under consideration here would push more traffic onto the highways, increasing congestion and placing more strain on our already burdened and under-funded highway infrastructure. The nation's dependence on foreign oil would increase, and there would be more emissions. Clearly, the Board should be looking for ways to encourage investment in rail capacity, not taking steps that are likely to discourage it.

B. Expanded Regulation Will Endanger Service and Efficiency

Mr. Fritz's statement explains how forced access and forced interchange requirements would create serious problems for Union Pacific's rail operations (as well as those

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[5] *See id*. at 5-8, 18 and 25.

of other railroads). We operate a highly complex network, and we have invested billions of dollars in tailoring it to provide better, more efficient service. We also have devoted great effort to managing the network in a way that reduces costs and improves service. As Mr. Fritz describes, we structure our operations carefully and invest capital selectively, all with the goal of producing maximum value for our customers and maximum efficiency for our operations.

Giving shippers the ability to force access by other railroads or to force the use of specified interchanges would cripple the valuable services we provide to our customers. Instead of advancing efficient operations to reduce costs and enhance service, as we have done with our transportation planning and nearly $30 billion in investments since 1999 alone, we would lose control of transportation planning and service delivery. Our operations would become more complex, and traffic flows would be fractured and less efficient. Those changes would increase costs and diminish service over the entire system, affecting all shippers. Shipments would move more slowly. Shipper-owned cars would be used less efficiently. Reliability would decline. We know this because, under pre-Staggers Act government restraints, railroads operated that way.

Moreover, our reduced ability and incentive to invest in infrastructure would affect our operations and customer service. We learned this lesson from painful service failures. Most notably, major causes of the post-merger service crisis in 1997 and 1998 included an under-maintained Southern Pacific network; shippers shifting traffic from Southern Pacific to Union Pacific routes in search of better service; a simultaneous traffic surge; and lengthy repair curfews to rebuild Southern Pacific's route west of New Orleans. Service at our Houston facilities melted down because the infrastructure was inadequate, and service problems cascaded throughout our system and beyond to connecting railroads, resulting in a national rail service crisis. Our 2003-05 service problems, when we did not have enough crews to handle traffic

growth in our western region, gave us another sobering lesson in the importance of adequate investment and careful network planning. Congestion can develop quickly in a complex, interconnected rail network. Allowing shippers to override our service design plans and reroute cars without regard to infrastructure and resource constraints would leave the rail system vulnerable to systemic weakness and failures. Service crises would be more likely.

Forced access and forced interchanges have the potential to return the rail industry to the balkanized routing patterns of the pre-Staggers Act era and otherwise interfere with quality service. To avoid responsibility for causing such harms, the Board should decline to impose regulation that presents so many risks for railroads and their customers.

III. THERE IS NO NEED FOR NEW REGULATION

The Board should not risk the consequences I have described, because there is no need for forced access and forced interchange. With rates below 1980 levels, adjusted for inflation, and rate regulation that already is painful for railroads, additional regulation serves no desirable purpose.

Moreover, Union Pacific faces robust and pervasive competition today. Most Union Pacific customers have access to more than one railroad, either directly or through a transload or intermodal option. (Our Union Pacific Distribution Services subsidiary is extending transloading and logistics services to a wide variety of customers, many of whom are served by other railroads, and intermodal service is drawing some carload shipments into trucks and containers.) Most of our customers have trucking and other options. As Eric Butler, who leads our Industrial Products group, testified in the exemption hearing in February, we must replace 10 percent or more of our Industrial Products business each year because of competition from other railroads and motor carriers. Some shippers who claim that they have no options, including

aggregates shippers, not only tell us about their truck options but also sometimes prove the point by moving product by truck.

Where a shipper is served only by Union Pacific, it is not because we have taken steps to shut out other railroads. Rather, it is because demand is insufficient to induce private capital to fund multiple railroad service. Many of these shippers have access to some form of competing service, via truck or water, and can use alternative sources or production facilities. Even solely-served shippers without good alternatives have bargaining leverage in negotiations. We are always sensitive to the need to keep our customer competitive — an important constraint on our rates.

I meet with many of our customers, often at the level of the President or Chief Executive Officer. At that level, most of our customers understand that we must increase revenues in order to invest more, and they are not concerned with forced access and forced interchange. Their greater concern is whether Union Pacific will continue to invest in their future, so that they can count on reliable service that allows them to be competitive and to expand their businesses. Preserving a regulatory framework that serves those interests, by encouraging rail investment and operational efficiency, should be the Board's top priority.

CONCLUSION

As I mentioned at the outset, the Board has very little room to get things wrong in this proceeding. It must avoid actions that are likely to discourage investment in the rail network and to take the industry backward to a time of government-compelled inefficiency. Understandably, some shippers with limited rail options want changes to the regulatory scheme to improve their own economics. But the changes they propose would hurt all shippers, including them. Railroads need differential pricing and the freedom to choose efficient routes in

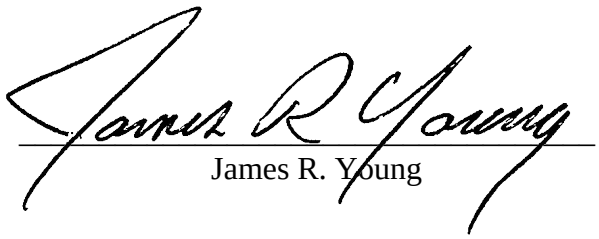
order to maintain a robust rail system with a high level of customer service. Adopting measures that will artificially depress rates or force less efficient, balkanized routes will threaten the important progress Union Pacific and other railroads have made since the Staggers Act.

If Union Pacific cannot look forward to earning market-based returns on its investments, but instead is limited to artificially constrained returns, we will have no choice but reduce investment, to the detriment of all shippers and the public interest. Important capital projects will go unfinished, and traffic will move to other modes (increasing highway congestion and emissions), as investors move their funds to other, more promising options. Imposing regulation that interferes with natural market forces will lead to retrenchment, removing our ability to accommodate traffic growth and significantly reducing efficiency and customer service levels. In the long run, new regulation of the sort the Board is considering would return railroads to the pre-Staggers Act days of disinvestment, poor service, and stagnation — a result wholly contrary to the public interest.

VERIFICATION

I, James R. Young, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on April 11, 2011.



James R. Young

BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 705

COMPETITION IN THE RAILROAD INDUSTRY

VERIFIED STATEMENT

OF

LANCE M. FRITZ

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VERIFIED STATEMENT

OF

LANCE M. FRITZ

My name is Lance M. Fritz. I am Executive Vice President - Operations for Union Pacific Railroad Company. I have overall responsibility for Union Pacific's rail operations throughout our 23-state rail network. I am in charge of all transportation services, including management and maintenance of locomotives, rail cars, tracks, train dispatching, and crew calling.

I began my career with Union Pacific in Marketing and Sales in 2000 as Vice President and General Manager - Energy. In 2005, I moved to the Operating Department as Regional Vice President - Northern Region, where I was responsible for the day-to-day safe operations of trains in Colorado, Iowa, Illinois, Kansas, Minnesota, Missouri, Nebraska, Wisconsin, and Wyoming. In 2006, I became Regional Vice President - Southern Region, which includes Arkansas, Kansas, Louisiana, Oklahoma, and Texas. In 2008, I was named Vice President - Labor Relations, responsible for negotiation and administration of all collective bargaining agreements with Union Pacific's more than 40,000 unionized employees. In January 2010, I was named Vice President - Operations. I was promoted to my present position in September 2010.

I understand that the Surface Transportation Board is considering changes to its rules about when a railroad must give access to a competing railroad. The changes could force railroads to interchange traffic that they could otherwise handle in single-line service, that is, without interchanging with another railroad ("forced interchange"). They could also force railroads to enter into terminal switching or trackage rights arrangements that would give a

second railroad access to solely-served shippers ("forced access"). Those proposals would threaten safety, degrade service, and destroy efficiency.

I. OVERVIEW

Union Pacific is operating at record high levels of safety and service, providing greater value to its customers than ever before. In large part, these accomplishments are a result of regulatory policies that allowed us to earn revenues needed to invest in our network and to plan the flow of traffic over our network. By coordinating our investment and transportation plans, we have improved the efficiency and predictability of our network, which in turn produces better safety and service. We invested for and are providing the single-line service benefits that the Interstate Commerce Commission and the Board sought in every major rail consolidation since 1980. This progress would be reversed if shippers could force us to provide access to other carriers without any regard for the impact on network operations or on other shippers that depend on our service.

Safety is a foundation of our business and our service to customers. We view safety and service as co-dependent goals: improvements in safety produce improvements in service, and improvements in service produce improvements in safety. By routing traffic to concentrate density on preferred routes, we have been able to systematically rebuild and replace old infrastructure, using new and better components and technology that enhance safety as well as service. We have also been able to standardize operations. As operations become more predictable, consistent, and repeatable, they become safer and more productive. Union Pacific and its employees have reduced reportable personal injury and reportable rail equipment incident rates to record-low levels.

We are driven to provide customer value, and our service levels are as high as they have been since Congress enacted Staggers in 1980, improving steadily since 2005. Our customers

recognize the value of our service, awarding us a best-ever average score on our Customer Service Index in 2010.

Union Pacific has spent the past several decades building and restructuring our network and improving transportation plans to match our resources with customer needs. Since 1980, we have consolidated six railroads into an efficient system, removing bottlenecks and inefficient operations, including unnecessary interchanges, and increasing single-line service. Although we stumbled in getting here, Union Pacific today is more effective than the sum of the individual merged railroads. We have been able to provide safer, better, and expanded service because of our ability to leverage the economics of consolidation.

Since 1999, we have invested almost $30 billion of capital. We aligned our capital spending with our basic operating strategy of concentrating traffic where possible on higher-capacity, higher-density corridors. We invested heavily in modernizing and increasing the productivity of our rail yards and other terminal facilities. All of this minimizes variability, reduces time-consuming interchanges, and allows us to move traffic safely and efficiently from origin to destination.

We also devote tremendous effort and technology to make a complex network serve many types of customers with integrated, quality service. Union Pacific's transportation planning process furthers our basic network goals of producing fewer, larger trains, and fewer work events.[1] This allows us to move more rail cars further without stopping en route. It also makes the most productive use of our locomotives and crews, reduces car cycle time, and increases the total amount of freight we can move. By reducing stops en route and terminal switching, we reduce safety risks, costs, and delay.

[1] Work events include stopping to set out or pick up cars on a rail line or in a rail yard.

Union Pacific must plan its capital investments and its operations carefully. The investments we make to expand and enhance our network are very expensive, require a long lead time, and last for decades. Most track and terminal expansions require at least three years from concept to operation. We must design the project, gain community support, secure property for the project, obtain permits, relocate roads and utilities, and then construct.

Forced access and forced interchange would reroute traffic from the routes and facilities where we have invested billions, scattering them to less efficient routes and interchanges that are not suited for more traffic. The negative impacts could be devastating, particularly in terminal areas like Chicago and Houston, where big increases in interchange volume could cripple operations. The rail industry would move backward several decades to a time when most routes were open and all provided inferior service. The operations would also be less safe because traffic would be diverted away from "hardened" (upgraded with stronger and better components) infrastructure and established service patterns.

Forced access and interchange would also diminish our ability to plan future operations and make capital commitments. If we cannot control the routes over which traffic would flow on our network, the economic attractiveness of most investments would decline. We could not predict whether any particular investment would generate a reasonable rate of return, especially if we must allow competitors to use the investment at below-market prices. We would also have less revenue to invest, because our operating costs would rise, and revenues would fall.

My most immediate concern is that shipper-driven access and interchange decisions would bottleneck service and could melt down the network. Disregarding our network structure and transportation plans by shifting traffic to new interchange points or overcrowding terminals creates a risk of cascading failures. Yards that have been efficiently designed to place cars going to certain destinations on certain trains could become swamped if network destinations suddenly

change as individual customers demand new interchanges. A train that needs no intermediate switching today might require switching so certain cars can move to various shipper-selected interchanges. Forcing new access and changing interchange points would add work events to busy rail lines with heavy through train density, thus slowing down the overall network, and reducing throughput capacity. We know from experience in 1997-98 how quickly a network can break down when it becomes congested with traffic, and Union Pacific will not voluntarily repeat that experience. The Board, however, might cause the next service crisis if its prudent access policy is reversed.

In this statement, I will describe Union Pacific's record-high levels of safety and service. I will also explain why forced access and forced interchange would undermine our investments and operations, to the detriment of shippers, our employees, and the public. In Appendix A, I will describe some of our most significant investments and explain how these investments have allowed us to realize record safety and service. Finally, in Appendix B, I will describe the planned investments that we hope to make to maintain these high levels of safety and service as demand continues to increase.

II. BECAUSE OF A STABLE REGULATORY ENVIRONMENT AND YEARS OF INVESTMENT AND WORK, UNION PACIFIC HAS EMERGED IN RECENT YEARS AS A SAFER, MORE RELIABLE RAIL CARRIER.

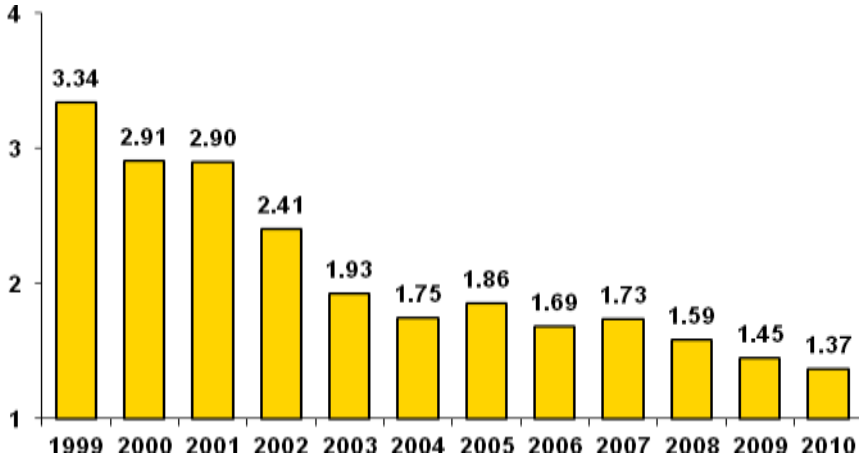
Our improving financial results are enabling Union Pacific to invest more heavily and to achieve major gains in safety and service.

A. Safety

With the support and engagement of our employees, Union Pacific's focus on safety allowed us to achieve our best-ever employee safety results in 2010. Our personal injury FRA reportable rate was 1.37 per 200,000 man hours in 2010, a 59 percent improvement over our

FRA reportable rate in 1999,[2] and a 6 percent improvement compared with our prior record in 2009.

Personal Injury FRA Reportable Rate (Figure 1)

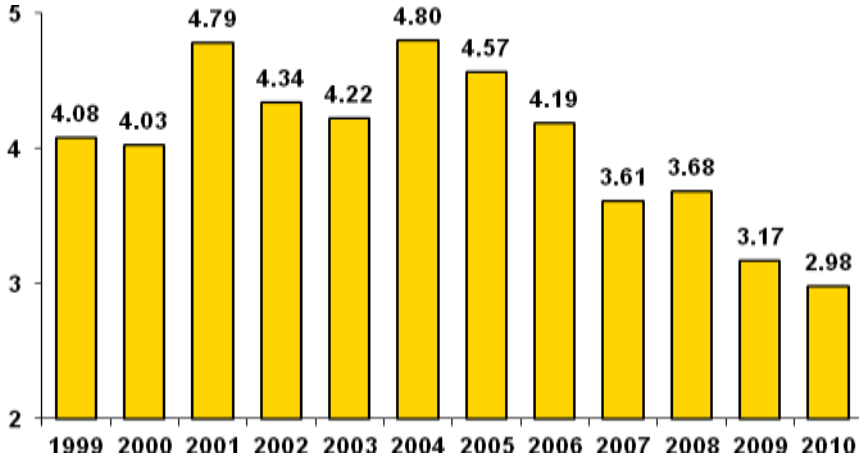


Our focus on safety also allowed us to achieve record results in what we call customer safety in 2010. Our rail equipment incident FRA reportable rate (a comprehensive definition that includes derailments and other incidents that interfere with reliable service) was 2.98 incidents

[2] We show various measures that compare to 1999, the first full year after Union Pacific had recovered from the service crisis that occurred after we acquired Southern Pacific.

per million train miles in 2010, a 27 percent improvement over our FRA reportable rate in 1999, and a 6 percent improvement over our prior record in 2009.

Rail Equipment Incident FRA Reportable Rate (Figure 2)



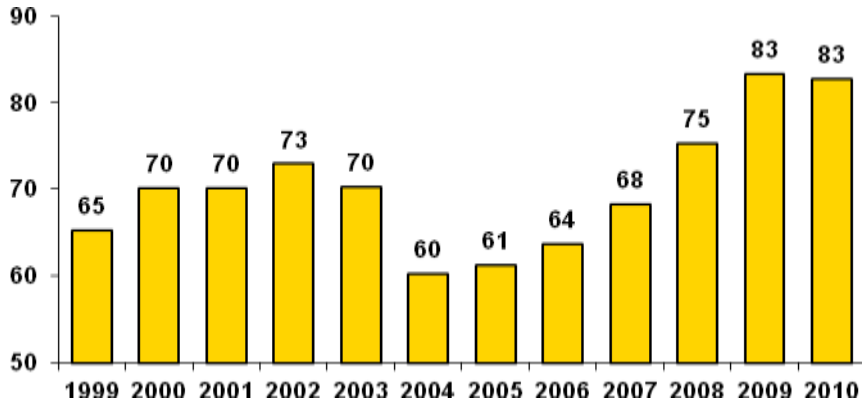
To increase safety, we have removed risks and created a safer environment through investments in infrastructure, technology, process improvement, and training. Our employees take personal responsibility for keeping each other safe. Our goal is continuous improvement toward eliminating safety incidents, which also yields better customer service.

B. Service

We are dedicated to providing valuable service to shippers and to never repeating our service failures of 1997-98 and 2003-05. In 2009, Union Pacific produced record service results, according to almost every metric that we track. Our challenge in 2010 was to move growing volumes of traffic while maintaining and further improving our performance. We achieved that goal. As traffic volume increased by 13 percent, from a recessionary low of 151,758 carloadings per week in 2009 to 171,764 carloadings per week in 2010, our key measures of service reliability and efficiency either essentially remained at record levels or improved. I illustrate this point below, showing various measures that compare 1999 to 2010. I also reference 2009 to demonstrate our ability to sustain and improve performance with increasing traffic that we handled from 2009's recessionary levels to the 2010 rebound in traffic.

Union Pacific's Service Delivery Index measures overall quality of service by whether cars arrive at their destination within established transit standards and schedules. (The higher the index, the better the service.) In 1999, the index stood at 65.[3] In 2010, the index was at 83, an increase of 18 points, or 28 percent. (If we include cars delivered early, the index was 90 percent.) This tied our record of 83 from 2009, when traffic volumes were lower.

Service Delivery Index (Figure 3)

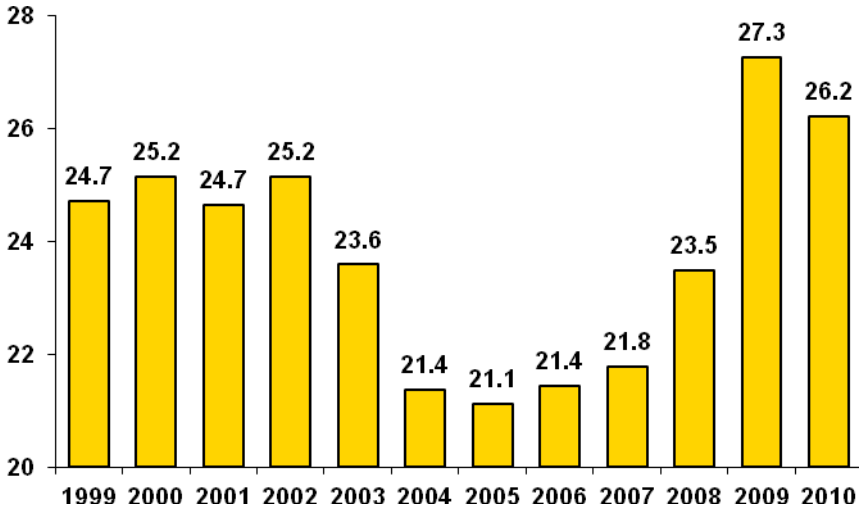


Union Pacific's average train velocity was 24.7 miles per hour in 1999. In 2010, our average train velocity was 26.2 miles per hour, an increase of 1.5 miles per hour, or 6 percent.

[3] In 1999, Union Pacific averaged 167,104 carloadings per week, about 3% lower than our 2010 carloadings, which should address any concern that the service and safety improvements are simply the result of much lower traffic volumes on our network.

This put us only slightly below our record of 27.3 miles per hour in 2009.

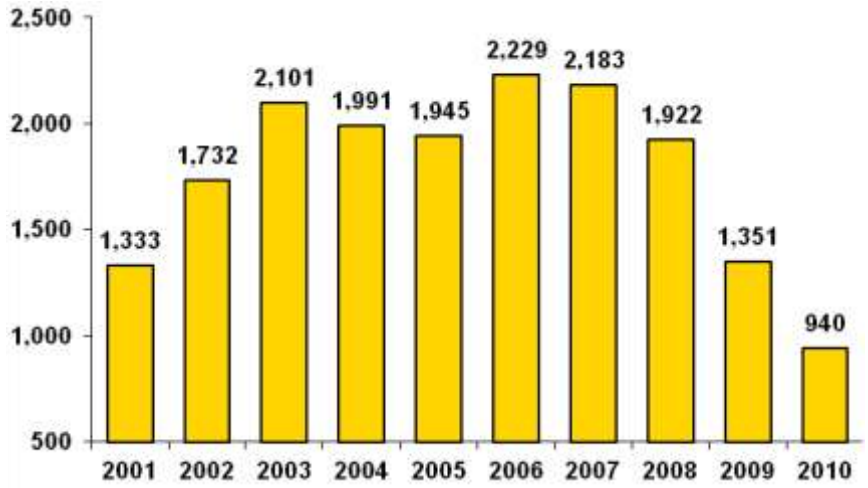
Velocity (Figure 4)



One reason our velocity remained high as traffic volumes increased is that we carefully planned to have all of the resources we would need to handle growth. We made sure that we had enough capacity, enough crews, enough locomotives, and enough cars in the right places and at the right time. We also made sure that our infrastructure had capacity and was ready. For

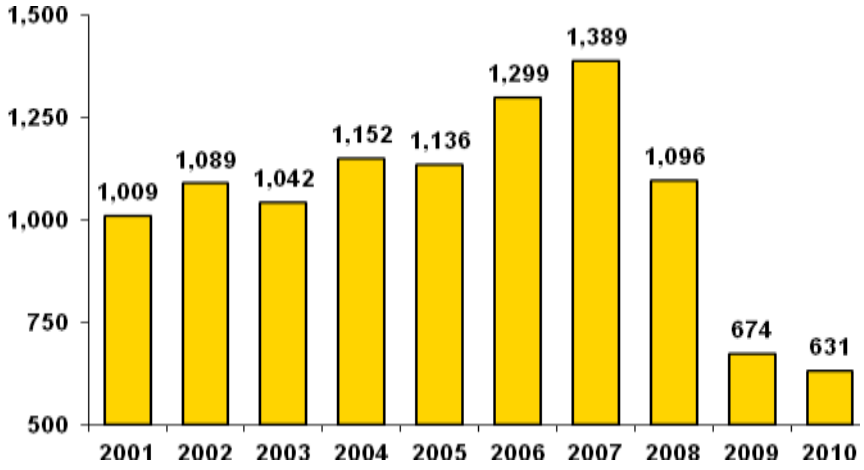
example, we had invested heavily to reduce slow orders. By the end of 2010, we had reduced slow orders[4] to a record-low daily average of 940 miles of track.

Miles of Form A Slow Orders (Figure 5)



As a result, delays from slow orders dropped to a record-low 631 hours per day.

Slow Order Delay Hrs/Day (Figure 6)

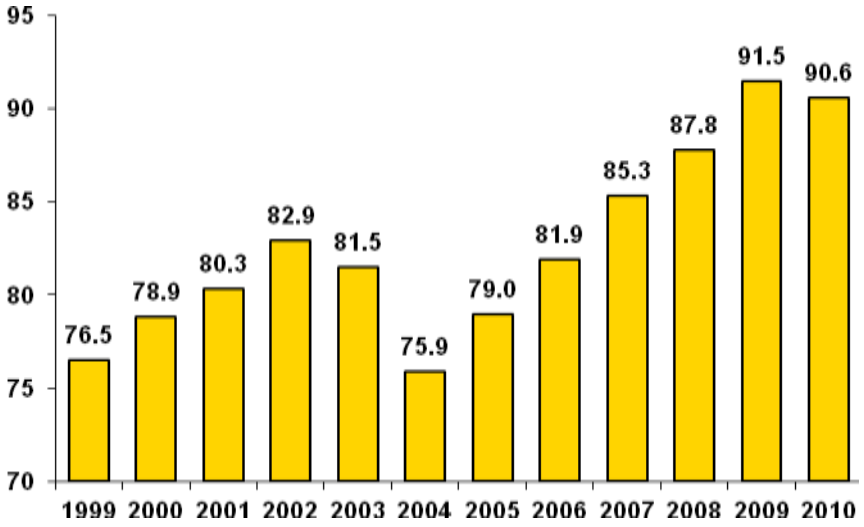


Union Pacific also continued to execute its transportation plan consistently, despite growing volumes. Our connection performance index, which measures whether cars meet the car scheduling plan at terminals, was at 76.5 in 1999. By 2010, we had improved connection

[4] "Slow orders" are imposed when track conditions require us to reduce speed limits under FRA or Union Pacific standards. The slow order is lifted and track speed limits are increased after we perform maintenance to address the conditions triggering the slow order.

performance to 90.6, an increase of 14 points, or 18 percent. This put us just below our record of 91.5 in 2009, and well above the prior best-ever result of 87.8 in 2008.

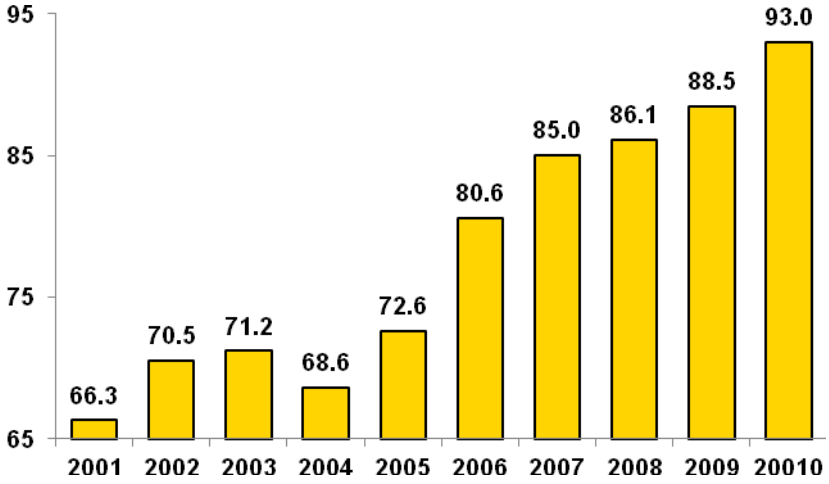
Connection Performance (Figure 7)



Another important measure of consistent execution is our industry-spot-and-pull average. This measures an aspect of our performance that is one of the most visible to our customers: whether we arrive at their facilities and switch cars when we say we will. Our 2010 industry spot-and-pull average was a best-ever 93.0 percent, above our prior record of 88.5 percent in

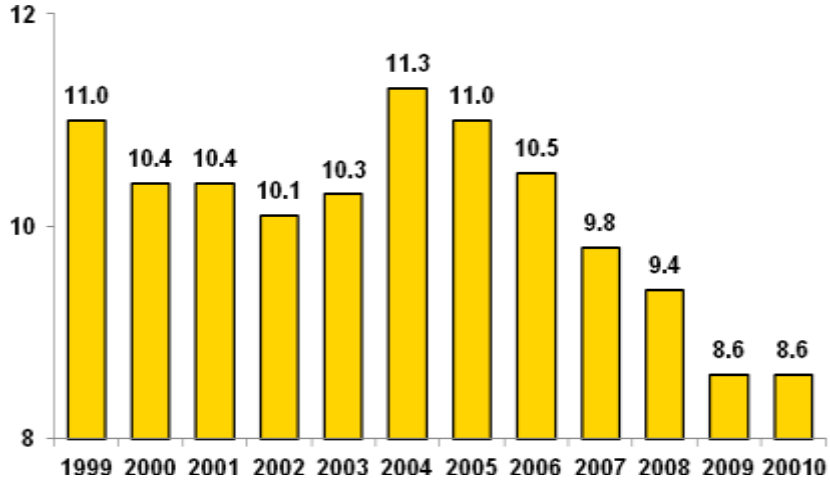
2009, and far above our score of 66.3 percent in 2001, the earliest year for which we have complete, consistent data.

Industry Spot and Pull Average (Figure 8)



Union Pacific also continued to increase efficiency. In 2010, we matched our best-ever freight car utilization of 8.6 days per cycle in 2009. Reducing cycle time – the number of days between loads – produces savings for both the railroad and our customers, because it means we and they need less equipment to transport the same volume of freight. By comparison, in 1999, our car utilization figure was 11.0 days per cycle.

Freight Car Utilization (Figure 9)

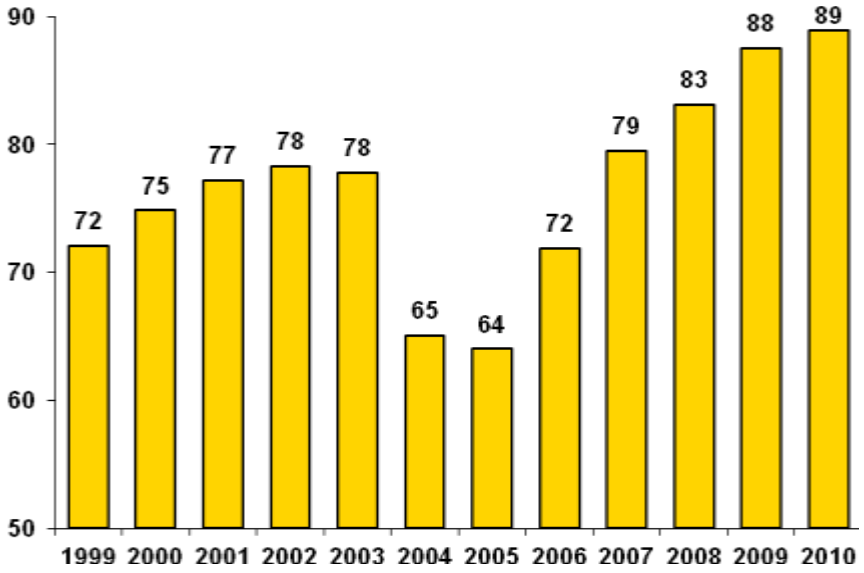


This improvement has been especially valuable for our chemical and plastics customers, who have been able to reduce their fleets of tank cars and covered hoppers.

C. Customer Value

Union Pacific's customers have recognized our efforts to improve service and safety and the results we have achieved thus far. One of the best indicators of how customers view our service and its value to them is our overall Customer Satisfaction Index. That index averaged a record 89 in 2010.[5] The 2010 result reflects a 17-point gain over the score of 72 that we received in 1999, and a one-point gain over our prior best-ever result in 2009.

Customer Satisfaction Index (Figure 10)

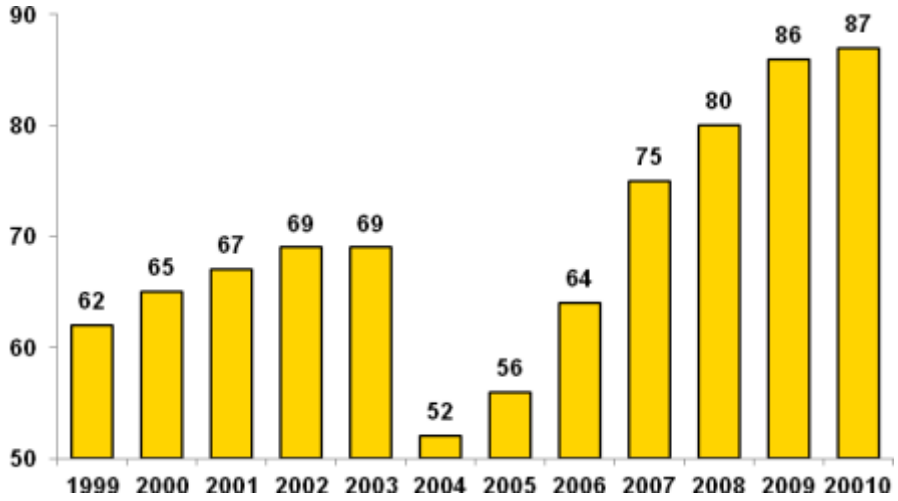


Union Pacific also specifically tracks and analyzes customer satisfaction with transportation service, though a series of questions regarding transit time and consistency, service with connecting lines, and adequacy of corrective action. The Transportation

[5] A perfect 100 score would indicate that all customers participating in the survey were "Overall Very Satisfied."

Satisfaction Index averaged a record 87 in 2010, which reflects a 25-point gain over the rating of 62 that we received in 1999, and a one-point gain over our prior best-ever result in 2009.

Transportation Satisfaction Index (Figure 11)



Another important indicator of how customers view the service and value we provide comes in the form of recognition by our customers. For example:

- We became the first railroad to earn the Eastman Chemical Company Supplier Excellence Award for overall company performance in 2009, and we earned the award again in 2010.
- General Motors honored us with its 2010 Supplier of the Year Award.
- Toyota Logistics Service recognized us as the top railroad in on-time performance and customer service in 2009, and we earned the customer service award again in 2010.
- Owens Corning named us as a Global Logistics Carrier Excellence award recipient for our service in 2009.
- Lowe's Home Improvement named us Rail Carrier of the Year for our service in 2009.

We are committed to continuing to provide high levels of service and value even as traffic volumes rise.

III. ASSUMING REGULATORY STABILITY AND ECONOMIC GROWTH, UNION PACIFIC EXPECTS TO INCREASE CAPITAL INVESTMENTS IN COMING YEARS TO MAINTAIN AND EXPAND SAFE, EFFICIENT, AND VALUABLE SERVICE.

Union Pacific has publicly told investors they can expect us to increase capital investment in line with revenue in coming years, unless the regulatory rules change. We want to make these investments to provide value to customers, to remain competitive, and to provide growth opportunities for our customers and investors. Many of those projects are underway. As Mr. Young explains in his verified statement, we already are raising capital investment from about $2.5 billion in 2010's shaky economy to about $3.2 billion in 2011. We have told investors to expect us to continue to plow 17 to 18 percent of our revenues back into the business in the form of capital investment for the next few years. As our revenues grow over that period, we expect our capital investments to grow proportionally, if the regulatory and economic environments remain supportive.

In Appendix B, I summarize some of the important investments that Union Pacific expects to make if the rules regulating railroads do not change substantially and traffic volume warrants.

IV. THE DANGERS OF FORCED ACCESS AND FORCED INTERCHANGE

Union Pacific has spent decades targeting investments and creating transportation plans to handle existing and anticipated shipper requirements. We have developed an integrated network of tracks and terminals and designed an operating plan so that we can move millions of carloads of traffic each year between thousands of origins and destinations and handle that traffic safely, reliably, and productively.

Forced access and forced interchange are fundamentally incompatible with reliable service and improving safety on our network. Shipper-dictated access and interchange decisions would disrupt operations on our lines and in terminals. They would force traffic over facilities

that were not designed to handle the business and reduce the productivity of the ones in which we have invested. The immediate result could be a service meltdown in major terminals. Even if we avoid short-term service failures, planning and allocating resources for the long term would become even more challenging than it already is. The unavoidable consequences would include higher costs, lower service quality, and less investment in our network. Union Pacific and its employees would suffer, but so would the shippers that seek forced access, as well as other shippers that are innocent bystanders.

In the sections below, I will describe operating plans that have resulted in safety, service, and efficiency and then explain why forced access and forced interchange would undermine network operations and decades of planning and capital investment.

A. Network Operational Efficiencies

Union Pacific manages a very complex network in which almost every decision affects the remainder of the system. Every day, we coordinate thousands of interrelated carload shipments so that they move reliably from origin to destination on trains and through intermediate switching yards, while also ensuring that intermodal and unit train traffic moves unimpeded from origin to destination. Changing the patterns of traffic flows on inadequate network was the root of the service crisis following the Southern Pacific merger. As we learned then, and as we saw again in the traffic surge in the middle of the last decade, problems on one part of the railroad network quickly spread to the rest of the network. In a carefully balanced network, we can reach a tipping point quickly.

We invest in our network to maximize traffic density and uninterrupted movement. In general, railroads can provide more efficient and better service when we have greater traffic density in a corridor. With more density, we can keep our locomotives in service more of the

time. We can schedule our train crews more effectively and efficiently. We can improve utilization of our track assets and spread the fixed costs of our network over more shipments.

More importantly, we can also move cars further distances without interruptions. We would much rather keep a car moving than switch it in a freight yard or at an interchange. Switching causes delay, often a day or more for each switch. It costs money for switch engines and yard crews. It reduces equipment utilization due to longer transit time. It increases the risk of damage to the freight. It reduces consistency and reliability. If we can get enough traffic density, we can build a through train to a more distant destination, whether on our railroad or others. Even if we do not have enough traffic for a full train, we can build a block of cars that will bypass an intermediate switch yard and avoid an additional switch. In other words, with enough volume, we can make our carload trains behave more like unit trains and move entire trains longer distances without breaking them up and switching the cars to new trains.

B. Examples Of Network Efficiencies Due To Control Of Routing and Train and Blocking Plans That Consolidate Traffic and Reduce Work Events

We build density and minimize switching through the investment decisions we have made over time and through our control of routing. As an illustration, Union Pacific generally tries to funnel as much Central Corridor carload traffic as possible onto our Nebraska mainlines and through Bailey Yard at North Platte, the world's largest freight yard. We have made massive investments to further this strategy and to increase capacity in our Central Corridor and at Bailey Yard.

For example, we usually route traffic from Kansas City to the West, including Denver via North Platte, even though we have a more direct route between Kansas City and Denver. By routing the traffic to North Platte, we can consolidate that traffic with shipments from Chicago, St. Louis, the Twin Cities, and many points from the South and East to build through trains and blocks for many points throughout the West, such as Los Angeles, Denver, Salt Lake City,

Northern California, and the Pacific Northwest. If we ran the Kansas City traffic straight to Denver, we would have to switch it in Denver, and there would not be enough traffic in Denver to make through trains or blocks to western destinations, so we would have to switch it again at Cheyenne or Salt Lake City. Using densities at North Platte, we can move shipments further and faster at lower cost, and we serve our customers more effectively.

Another way that we increase density and minimize switching is by directing traffic through the most effective interchanges. We can provide better, more efficient service by consolidating traffic into larger volumes over more suitable interchanges, allowing us to use run-through trains or blocks that run deep into our territory or the other railroad's territory. For example, Union Pacific has worked with Norfolk Southern to look at traffic moving between our systems. We jointly studied the interchange capabilities of gateways at Chicago, Kansas City, St. Louis, Salem (Illinois), Memphis, and New Orleans, and studied the services and service capabilities of our routes leading to each gateway. As a result of these joint efforts, Union Pacific began building a solid train at our Chicago Proviso Yard for NS's Pittsburgh yard. NS's Elkhart, Indiana, yard builds a solid train for our yard in North Platte, Nebraska. We assemble a block of cars in North Platte for NS at Sheffield, Alabama, via the Memphis gateway. NS builds a train for Houston at Sheffield. Union Pacific and NS comprehensively shifted traffic among gateways to keep it moving faster and to allow both railroads to build trains that can operate further without stopping. We have done the same with other railroads.

C. Forced Access and Forced Interchange Would Disrupt Efficient Routes and Transportation, Producing Poorer and More Costly Service

Forced access and forced interchange would destroy network efficiencies we built over decades. They would fragment traffic into smaller volumes that would require more switching. They would allow shippers to demand service changes without regard for impact on our network operations or on other shippers that depend on our service. Individual shippers would not have

any way to understand the complexities of our network design and efficiencies. Under a regime of forced access or forced interchange, our system-wide through-train and blocking plans would become less efficient, and our terminal performance would suffer as well.

Consider as an example is Union Pacific's carload service in the Sunset Corridor. To expedite customer shipments, avoid switching delays and congestion, and use facilities efficiently in this corridor, we eliminated work events on our busy mainline between the Los Angeles Basin and El Paso, and limited the amount of switching that occurs in the space-constrained El Paso terminal. To do this, we use major rail yards throughout Texas to assemble large blocks of cars going to specific areas on the Sunset Route. Shipper-controlled access would weaken or wreck this efficient service network.

We consolidate shipments from throughout the southeastern part of our system at Englewood Yard in Houston, Davidson Yard in Ft. Worth, and SoSan Yard in San Antonio. We then run trains direct to destination (and back) from Houston and Ft. Worth to the Los Angeles Basin, avoiding work events on the Sunset Route west of El Paso. All three yards also block Arizona traffic for Tucson, and these blocks move to El Paso, where they are combined without switching in El Paso into a train for Tucson that does no work en route.

This coordinated, network approach consolidates shipments so that they move as far as possible without delays. It avoids delays to dozens of other trains on our busy Sunset Route. Importantly, it also balances switching duties among our yards in Houston, Ft. Worth, San Antonio, El Paso, and Tucson, so that those yards can handle other planned traffic efficiently and without congestion. We minimize transit time for the largest number of customers possible.

All of these benefits would be at risk under forced access and forced interchange because we would lose control of how we route cars on our system. With no knowledge of network effects and impacts, and acting in their short-term interests, individual shippers could shift cars to

interchange points with BNSF and KCS that would add extra work at our yards and scatter the existing densities among multiple, fragmented routes. For example, shippers might divert traffic from efficient interchanges to our interchange with BNSF at Sweetwater, Texas, where trains would have to stop, blocking other trains on our busy line from Los Angeles to Dallas/Ft. Worth, Memphis, and other South Eastern markets. Neither we, nor other customers, can afford those delays. All of the interchanged cars would require additional switching at a terminal that is already space constrained.

Another possibility is that shippers might want to interchange cars at Deming, New Mexico, forcing trains to perform work events on the Sunset Route and adding to switching burdens at El Paso and Tucson. Or shippers might decide that they want cars to be interchanged in Phoenix, which is on Union Pacific and BNSF secondary lines and has limited room for switching and interchange. In 2004, Union Pacific's service almost came to a standstill in Phoenix when too many cars crowded into the terminal.

To take another example of the potential adverse impact on train performance and in terminals, Union Pacific gathers large volumes of chemical shipments from customers southeast of Houston on what we call the Bayport Loop. We have enough traffic from the Loop to launch a through-train from Bayport (Strang Yard) to Livonia Yard, our major switching yard near Baton Rouge, avoiding further switching – and congestion – in our Houston yards. At Livonia, Union Pacific makes trains and blocks that run deep into the NS and CSX systems for efficient service. We also run a train from Strang to the Alton & Southern Gateway Yard in East St. Louis. This train also avoids switching the cars in Houston and carries blocks for eastern connections.

Forced access and forced interchange put all of this in danger. For example, if shippers decide to interchange significant numbers of cars to BNSF at Houston, our efficient services

from Strang would collapse due to lack of volume, and BNSF and Union Pacific would face congestion in Houston. The congestion may be severe. We would have to send interchange cars to our Englewood Yard, where the additional cars would congest the yard. We would have to redesign our service plan to accommodate the cars that would still move via Union Pacific to interchanges with NS and CSX, which would add to our costs, and to the costs incurred by NS and CSX, as well as hurting service. The cars that would move via BNSF would need to be switched at Englewood into a BNSF connection block, delaying the cars by a day at Englewood. BNSF would then need to come get them, which would take additional time. BNSF would move the cars to its New South Yard, which appears to me to be near capacity already. After losing another day for switching at New South, the cars would eventually get out of town on a BNSF train for New Orleans.

Using Union Pacific's current services through Livonia and East St. Louis, which depend on the volumes we can assemble at Bayport, we can move cars east of the Mississippi River before the movements described above could get out of Houston. Some of those shipments are chlorine cars, which would spend two or three extra days in Houston, contrary to the strong public policy of minimizing the time hazardous materials dwell in high population areas. All affected shippers would lose quality service.

We would also face severe deterioration of service if shippers decided to redirect large amounts of the traffic that now moves efficiently through Livonia and instead interchange that traffic at Baton Rouge to KCS or Canadian National. Union Pacific's line from Livonia to Baton Rouge and our interchange facilities there are not built to handle significant volume. Cars would be delayed and the facilities would become congested. Even if we could accomplish the interchanges, our efficient blocking scheme for eastern movements from Livonia could be destroyed if volume were siphoned off through Baton Rouge.

Some forced interchanges would hurt service because our physical interchange facilities with other railroads, and the tracks leading to those interchange points, were not built to accommodate operations that shippers might demand in a forced access or forced interchange regime. For example, a shipper might decide to force Union Pacific and BNSF to interchange many more shipments at Tulsa, Oklahoma. Tulsa lies at the end of a Union Pacific branch line that begins near Muskogee, Oklahoma. The line from Muskogee to Tulsa is not suitable, in its current condition, for large volumes or for heavy traffic, such as unit coal trains, with bridges limited to 20 miles per hour. In Tulsa, we have only two tracks in the median of a major highway. Interchanges would require additional switching by BNSF at its Tulsa yard and by Union Pacific at Muskogee, causing congestion and delay. If BNSF and Union Pacific were forced to interchange coal traffic at Tulsa, Union Pacific would be expected to divert capital from more worthy projects to upgrade the Tulsa branch.

D. Increased Variability

Another issue is that customers could frequently switch access and interchange decisions, so that efficiency could not be achieved. We would not know with certainty where cars will move or be interchanged, in stark contrast to our current planning process, in which we change course gradually and deliberately with changes in markets. Predictability and consistency are critical to driving safety, service, and efficiency.

E. Forced Access and Forced Interchange Would Add Costs and Create Delay Across Union Pacific's Entire Network

On a broader scale, forced access and forced interchange would make our entire network less efficient because traffic would be diverted from the most efficient routes, reducing densities on those routes and thus unraveling the efficiencies that Union Pacific has built over decades. Cars would require additional handling, and thus we would need more terminal capacity, as well as more locomotives and crews to handle traffic in yards and on local trains that would be

needed to move the traffic to additional interchange locations. And even if the shippers that demand the new or different interchanges gain some short-term rate advantage for themselves, they will have done so at a steep cost to the many other shippers that benefit from our existing service, and ultimately to the very rail network that serves them.

Moreover, I believe it is unlikely that any shipper with single-line service that forced Union Pacific to interchange at new locations would obtain any service benefit. From an operating standpoint, there is no doubt that single-line service, where one railroad has the ability to manage service over its own routes, is almost always superior to interline service. Movements requiring an interchange between railroads are always subject to inefficiencies because they require the railroads to coordinate their operations. Even under the best of circumstances, when railroads have strong incentives to cooperate to provide service, the coordination challenges can be difficult or impossible to overcome because the railroads ultimately have different overall priorities for their systems.

At a more basic level, the physical process of interchanging cars between railroads creates delay and inefficiencies. Unless there is enough traffic going to the right place to justify run-through trains, one railroad must switch cars for the other and then deliver them. The other railroad then must switch them again. Transit time and equipment utilization suffer. Except where the railroads have enough volume to use run-through trains, one of the carriers must use its locomotives and crews to make the delivery, and both must typically switch the cars to take them to and from the interchange. In addition, recent rules have imposed costly additional requirements for interchanges of hazardous materials, including human handoff between carriers at interchange. All of these inefficiencies are avoided by single-line service.

Forcing railroads to grant trackage rights to shipper facilities would be particularly pernicious. It would raise operating costs by requiring two railroads to operate at facilities that

were never constructed for use by multiple carriers. This potentially doubles the use of limited infrastructure in the most constrained parts of our network. It may also result in additional switching, which could greatly reduce our ability to sort cars for our own network. Both railroads would incur added costs in attempting to coordinate their services, and, even with those efforts, interference and conflict are almost inevitable. Moreover, operational conflicts would likely affect not only the shipper that created the situation, but also any other shippers within the terminal area. Shippers usually do not like to interrupt their activities twice per day for dual service.

F. Forced Access and Forced Interchange Would Sacrifice Capital Investment Efficiencies

Forced access and forced interchange would also undermine our past and future capital investments. Forced access and forced interchange would require us to spend more to provide the same level of service, would strand investments that we previously made based on expectations that traffic flows would follow efficiency principles, not regulatory principles, and would make future investments more risky, and therefore less likely.

Forced access and forced interchange will result in inefficient service and higher costs. They could also leave Union Pacific with stranded or underutilized investments in rail lines and yard facilities. For example, as I note in Appendix A, Union Pacific invested $145 million to transform Davis Yard in Roseville, California, into the premier switching facility (classification yard) on the West Coast and allow us to consolidate traffic previously handled by many smaller yards. Under a forced access or forced interchange regime, shippers could decide to interchange cars between Union Pacific and BNSF or shortlines throughout California, such as at Stockton, Sacramento, Fresno, Oakland, Warm Springs, and Bakersfield, which would undermine our investment in Davis Yard and increase the need for expensive switching and local train operations at other points.

As another example of the potential for stranded investment and worse service, Union Pacific has continually refined its service to soda ash shippers in southwestern Wyoming, site of the world's largest deposit of soda ash. We just opened a new $23.9 million yard at Westvaco, Wyoming, to support this service. We assemble through trains that operate without delay or switching to Bailey Yard (North Platte, Nebraska), where the cars are distributed to our network of trains destined to points throughout the Midwest, South, and East. Shipper-directed interchange could destroy this efficient operation and impose new costs on Union Pacific. Shippers might decide to divert some of their shipments to interchanges with BNSF at Cheyenne, Denver, or Salt Lake City. This would break up the volume that allows us to operate the North Platte through-trains. It would require us to develop a less efficient, more expensive service to Salt Lake City, or Denver, or Cheyenne, where the interchanges are cumbersome and not suited to large volumes. The new service would be much slower, reducing utilization of shipper-owned and rail-owed equipment. For the entire service, this would be a leap backward and reduce use of our investments.

Finally, a regime that included forced access or forced interchange would make it even more difficult than it is today to engage in capacity planning or to fund capacity projects. We would have no assurance that, if we made an investment on any route, shippers would keep their traffic there. We cannot shift our investments as quickly as shippers could demand a new interchange. We cannot invest without some assurance of a reasonable return. Once our capital dollars are spent, most of them cannot be removed from the ground. We would also find it more difficult to determine whether to hire and train additional crews for particular locations. Even if shippers invoked forced access or forced interchange only rarely, the lack of predictability increases our risk and thus reduces our ability to invest.

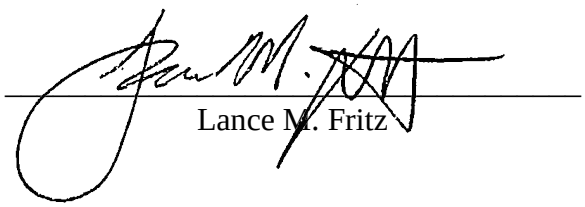
V. CONCLUSION

Union Pacific is providing safe, reliable, efficient service and value to customers, and we are investing to meet growing demand. Forced access and forced interchange would undermine the progress we have made by counteracting our efforts to maximize density and uninterrupted movement. At the same time, forced access and forced interchange would result in wasted spending and reduce our ability to make investments that will benefit the rail network. The Board should reject any proposals to implement such a counterproductive regime.

VERIFICATION

I, Lance M. Fritz, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on April 11, 2011.



Lance M. Fritz

APPENDIX A

APPENDIX A: CAPITAL INVESTMENT AND IMPROVEMENT

UNION PACIFIC'S ACHIEVEMENTS HAVE BEEN MADE POSSIBLE BY MASSIVE INVESTMENT IN OUR NETWORK.

Union Pacific's high levels of service and safety rest on a foundation of massive investments to expand and enhance our operations over the past 30 years. Through a series of transactions that culminated in our acquisition of Southern Pacific, Union Pacific has grown from a carrier operating 9,315 miles of railroad in 13 states to a complex network that operates more than 32,000 miles of railroad in 23 states. By combining traffic flows on the most efficient routes, and investing in those routes, the consolidated Union Pacific provides safer and better service than any of our individual railroads could have. Union Pacific spent billions of dollars to acquire other carriers, upgrade their facilities and equipment, and integrate their operations to create today's railroad.

Union Pacific has spent additional billions of dollars to remove bottlenecks from the network we created, to remove interruptions and variability from our service, and to harden our infrastructure. Today our network provides tremendous benefits to shippers by expanding our ability to provide single-line service, creating shorter routes, eliminating service-killing inefficiencies, and increasing capacity.

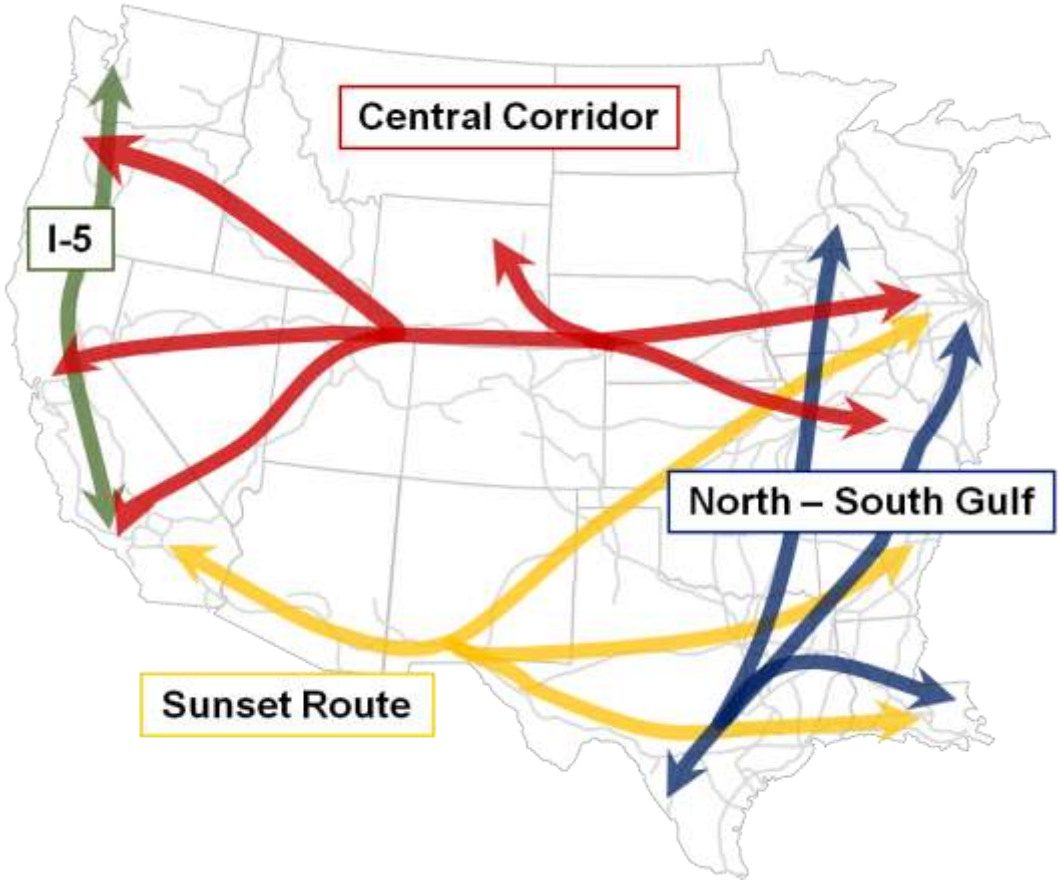
In the sections below, I provide examples of the investments we have made to improve safety, capacity and service. Our ability to maintain the gains we have achieved and to continue investing to address shipper demand for expanded and enhanced service is, however, threatened by the potential revenue and operational impacts of a regulatory regime that would include forced access and forced interchange.

A. Investments in New Track and Facilities

Particularly as our revenues have improved, we have been investing more in new track and terminal facilities. These investments are designed to promote the efficiency and reliability of our service to customers. They improve performance by keeping our mainlines and yards fluid as volumes increase, often by removing bottlenecks that cause delay and constrain growth.

We think about our investments by corridor. Although we shift trains between corridors for flexibility, we invest to ensure that our major corridors serve customers well. I will summarize some of our most significant investment in recent years in our four major corridors.

(Figure 1)



Central Corridor. Union Pacific's Central Corridor, which includes the original transcontinental railroad from Council Bluffs, Iowa, to Sacramento, California, extends from Chicago to Northern California, with extensions to the Los Angeles Basin and the Pacific Northwest.

In the Chicago area, Union Pacific has invested substantially, along with others, in the CREATE projects. CREATE involves most of the railroads serving Chicago, as well as regional, state, and federal agencies, in an ongoing series of projects that will improve passenger, freight, and vehicular movement through the congested Chicago area. We have already constructed a new rail line eastward from our major rail yard in Chicago, Proviso Yard. This important route allows trains to leave our Proviso Yard for eastern connections without conflicting with Metra commuter trains. Also, as part of CREATE, Union Pacific is constructing a new connection between our Proviso Yard and the Indiana Harbor Belt Railroad, which carries freight to and from other railroads in the Chicago area. That $82 million project will allow more fluid interchange of large volumes of traffic through Chicago. The picture showing progress as

of the end of March is provided below and help show why these big projects require years of planning and preparation.

(Figure 2)

A major capacity enhancement in recent years added more than 290 miles of Centralized Traffic Control and universal crossovers between tracks at numerous locations on the double-tracked, former Chicago & North Western line across Iowa. (I will refer to the automated switches, signals and new crossovers as "CTC".) CTC allows dispatchers in our train-control center to operate switches remotely, eliminating the need for employees to stop their trains, throw switches, and walk the length of the train after it passes. By adding CTC from Denison, Iowa, all the way to the Mississippi River at Clinton, Iowa, we gained the ability to allow faster trains to pass slower trains, increased the reliability of all trains on the route, and avoided significant delays when interruptions occur.

We also added a 2,550-foot, double-track bridge 190 feet above the Des Moines River. This $48 million bridge allows two trains to cross the river at full speed, replacing the historic

Kate Shelley Bridge, which required trains to slow to 25 miles per hour and handled only one train at a time, causing significant delays. The picture below shows the old bridge on the left and the new concrete bridge on the right.

Kate Shelley Bridge – Boone, Iowa (Figure 3)

The largest capacity project on the Union Pacific system in recent years was a multi-year initiative to expand our coal-handling capability out of the Powder River Basin, costing almost a billion dollars over a decade. It included completing construction of 108 miles of third main line track between North Platte and Gibbon, Nebraska, in 1999; 106 miles of second main line track between Gibbon, Nebraska, and Marysville, Kansas, in 2000; 47 miles of second mainline track between South Morrill, Nebraska, and Shawnee Junction, Wyoming, and 66 miles of second mainline track between South Morrill and North Platte, Nebraska, in 2003. It also included purchasing and rebuilding a shortline railroad in northeast Kansas to create directional operations between Kansas City and Marysville. These investments allowed us to increase coal service

reliability, even as our volumes increased, and also provided capacity for grain, carload, intermodal, and automotive traffic that shares this high-density corridor.

Powder River Basin, Wyoming (Figure 4)

On the parallel "Kansas Pacific" route between Denver and Topeka, Kansas, Union Pacific invested over $350 million to entirely rebuild the railroad and add segments of CTC. We also invested $30 million in Denver to build a by-pass track and avoid having to back up trains in the busy Denver terminal. We use this route to move coal trains between Colorado mines and customers in the East, Midwest, and South. Some shipper groups argued when we acquired SP that Union Pacific would never invest to serve Colorado coal shippers, who are "captive." They were wrong, as over one-third of a billion dollars proves.

We have continuously upgraded the world's largest freight yard, our Bailey Yard at North Platte, Nebraska, so that it can now process more than 150 trains per day. These investments made sense because our control over routing decisions allows us to consolidate traffic in Bailey Yard and use the yard's capacity to build trains that can move long distances

without the need for additional switching. We also recently added a third main line through the yard at a cost of over $8 million, allowing trains running through North Platte to move through the terminal without interfering with other operations.

North Platte, Nebraska (Figure 5)

In western Wyoming, we recently completed a new rail yard to originate and terminate trains carrying soda ash. This helps our customers reach their markets efficiently and use their private equipment more effectively, reducing costs for both the customers and Union Pacific. We built this yard even though these customers, too, are "captive."

In Salt Lake City, Union Pacific constructed and opened a $90 million intermodal facility west of the city. We also participated in a public-private partnership to modify a notorious bottleneck in Salt Lake City at Grant Tower, increasing train speeds through Salt Lake City from 10 miles per hour to 40 miles per hour. On our line from Salt Lake City toward Los Angeles, we

lengthened several sidings so that we can operate longer trains, as we are doing on our line to the Pacific Northwest.

In northern California, we recently improved clearances in tunnels on our Donner Pass line to allow full-size double-stack intermodal trains to operate on this most direct transcontinental line. This project allowed us to reroute numerous trains per day from a 70-mile-longer route through the Feather River Canyon. The Feather River Route deserves additional mention. Twenty or thirty years ago, Union Pacific would not have been able to afford to maintain this second rail route through the Sierra Nevada, as it recently has handled only about two trains per day each way. With higher revenues, we not only retained the Feather River Route, but also invested millions of dollars last year to upgrade it and remove slow orders. When the heaviest snows in 120 years hit Donner Summit last month – 15 feet in 10 days –

Union Pacific was able to reroute almost 20 trains per day via the Feather River Route, avoiding significant delays for large numbers of shippers. That is the service value of investment.

Donner Pass (Figure 6)

At the western end of the Central Corridor, Union Pacific in 1999 opened the J.R. Davis Yard in Roseville, California, after a $145 million reconstruction project that transformed the yard into the premier classification yard on the West Coast. The new yard greatly increased efficiency by allowing us to consolidate traffic previously handled by many smaller yards and

build longer, dedicated trains that can move more directly to final destination or interchange with fewer time-consuming intermediate stops.

Davis Yard – Roseville, California (Figure 7)

South of Stockton, California, we constructed the Lathrop intermodal facility, serving domestic shippers throughout the region.

Sunset Corridor. Union Pacific's Sunset Route connects the Los Angeles area with El Paso. The Sunset Route has the lowest, flattest crossing of the Continental Divide in the United States. This is the most direct route to major Gulf and Southeast markets, which are projected to continue growing. We include in this corridor not only the former SP line from El Paso east to San Antonio, Houston, and New Orleans, but also the former Texas & Pacific line from El Paso

to Dallas/Ft. Worth and Memphis, and the Shreveport Gateway, as well as the former SP-Rock Island line from El Paso to Kansas City and Chicago.

Sunset Route (Figure 8)

Union Pacific's progress in double-tracking the Sunset Route provides another major example of investment to expand capacity and improve efficiency. When Union Pacific acquired Southern Pacific, the line from Los Angeles to El Paso was mostly a single-track line that had difficulty accommodating Southern Pacific's volumes. Lacking revenue to invest, Southern Pacific cannibalized its Central Corridor route by shifting rail from Nevada to the Sunset Route. With growing revenue, Union Pacific added a second track from Tucson to El Paso and on mountain grades east of Los Angeles. As of the end of 2010, approximately 61 percent of the line is double-tracked. The added capacity has been essential to our ability to improve service for the vast quantity of intermodal, automotive, agricultural, and carload shipments that use the line, which now carries about 20 percent of all Union Pacific traffic. At the west end of the

corridor, Union Pacific rebuilt Southern Pacific's major West Colton terminal, which serves carload customers throughout Southern California. We also added through tracks on our mainline, bypassing the yard, as well as more tracks in the yard, and a modern diesel locomotive shop.

On the eastern extensions of the Sunset Corridor, Union Pacific has invested in new intermodal terminals. The $100 million San Antonio facility not only serves customers in that area, but also traffic to and from Mexico. In Dallas, Union Pacific created the Dallas Intermodal Terminal, investing another $100 million and sparking rapid industrial development southeast of Dallas. Near Memphis, we constructed a new intermodal terminal at Marion, Arkansas. In the Chicago area, we recently opened the $370 million Joliet Intermodal Terminal, which is already a major terminal for shipments to and from the West Coast. This important facility allows us to

meet customer demand for service from the Los Angeles-area ports to the highest concentration of distribution centers in the Midwest.

Joliet Intermodal Terminal (Figure 9)

Union Pacific also invested heavily in the former Texas & Pacific mainline between El Paso and Ft. Worth. This line carried as few as two trains per day on its West end two decades ago. It now carries 18-23 trains daily. Union Pacific rebuilt the railroad from the foundation up, increasing train speeds, and we built a number of new sidings and extended others to increase the number and length of trains the route can handle.

We have invested in many improvements in terminals and along mainlines in Texas and Louisiana. We improved Houston freight yards that struggled after Union Pacific acquired Southern Pacific. We installed connections and additional tracks to smooth the flow of traffic through that busy terminal. We added passing tracks and extended sidings to remove bottlenecks throughout Texas and beyond.

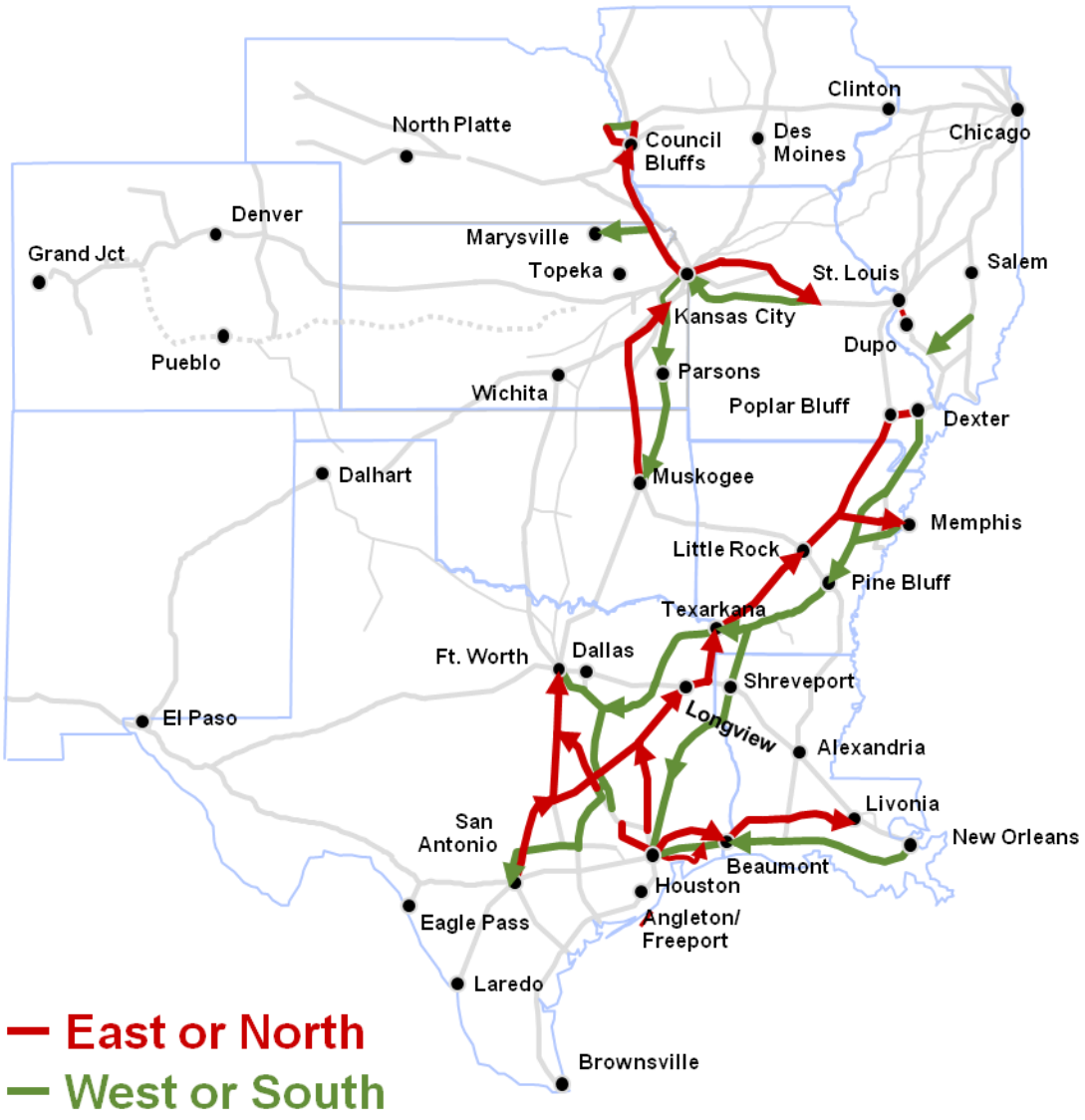
North-South Corridor. Union Pacific groups several routes into its North-South or Heartland Corridor. Moving from south to north, Union Pacific in recent years has had the funds to rebuild the "OKT" line from Ft. Worth to Wichita and beyond, using new rail and ties. We also added or extended sidings and double-track at numerous locations between Ft. Worth and Kansas City on other north-south routes.

Kansas City is the spoke of the wheel for Union Pacific lines in all directions, as well as a major interchange point. To handle over 100 trains per day, growing toward 150, we invested heavily to increase network efficiency. For example, we rebuilt Southern Pacific's Armourdale Yard into an efficient facility for automobile, coal and other run-through trains. We participated, as a member of the Kansas City Terminal Railway, in a public-private partnership to lift the KCT mainline over busy Rock Creek Junction in northeast Kansas City, and we streamlined the tracks through Rock Creek. We also shared in funding an expensive third main track along the BNSF mainline for about nine miles east of Rock Creek to give Union Pacific a clear route to our River Subdivision toward St. Louis that branches off of the BNSF line.

On our north-south corridor from Texas through Arkansas to St. Louis and Chicago, directional operation between Texas and Southern Missouri and Memphis gives us a substantial amount of capacity, although high-priority Amtrak trains moving against the directional flow are a daily challenge. We virtually rebuilt the former Southern Pacific (St. Louis Southwestern)

lines for primarily southbound operation from Missouri through Pine Bluff, Arkansas, all the way to Texas.

Principal Directional Flows (Figure 10)



We added signals for increased safety on the Shreveport-Houston segment because it carries Toxic Inhalation Hazard shipments. In southern Illinois, we added capacity on several line

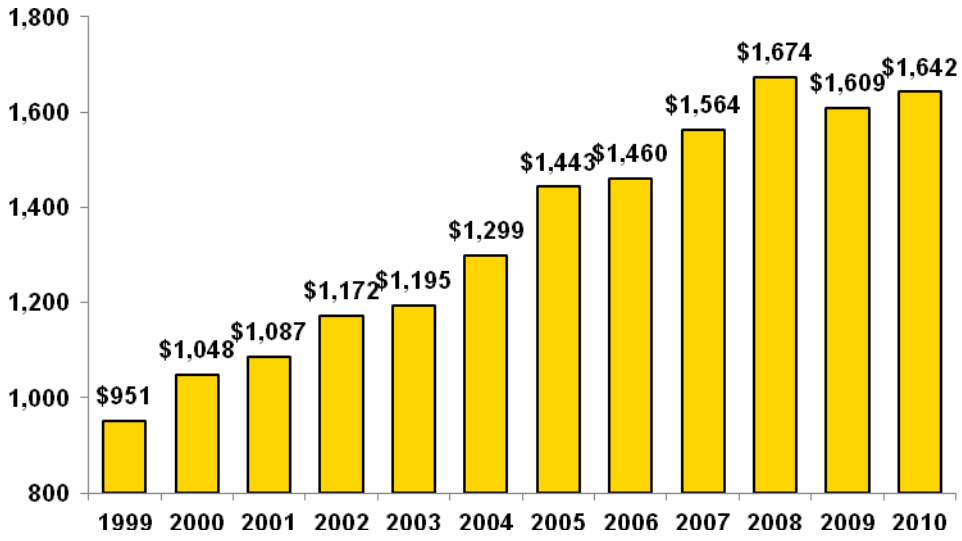
segments that carry Illinois coal or that connect our former Chicago & Eastern Illinois line from Chicago with our routes to Texas.

Growing revenues made all of these investments possible, and all are contributing to network service improvement and capacity growth.

B. Investment to Renew and Replace Existing Track and Facilities

As much as Union Pacific has invested to increase capacity and improve service by adding new track and facilities, we have invested even more to enhance service by improving and hardening our track and roadbed infrastructure. Since 1999, our annual investments have grown as we have replaced millions of ties and hundreds of track miles of rail across our network every year. We maintained this high level of investment even during the recession.

Replacement Capital Investment *(millions)* **(Figure 11)**



Our consistently high level of spending on replacement capital has been critical to our ability to provide fluid and safe operations and increase network efficiency in several respects.

First, our replacement capital spending has allowed us to reduce substantially the number of slow order miles across our system. As I observed earlier, by the end of 2010, we had reduced Form A slow orders on our network to a record-low daily average of 940 miles. This translates into a reduction in the hours of delay caused by track defects, which were also at a record-low of just 631 hours per day in 2010. Reductions in slow order delay protect velocity and consistency, which in turn means better service and improved asset utilization.

Second, replacement capital spending substantially reduced the number and impact of service disruptions caused by track and signal failures.

Third, when we replace aging assets, we often replace them with higher quality assets. These efforts to "harden" the railroad play an important role in furthering our goal of increasing reliability and safety. On all heavy-traffic corridors, we now install head-hardened, premium rail. With more premium rail and other actions, we have extended rail life from 2 to 3 billion gross tons. That means fewer interruptions to replace rail. In addition, when we replace ties, we are often installing concrete ties, which are more durable, and therefore require less frequent

replacement, than wooden ties. The before and after pictures below illustrate use of stronger rail and concrete ties to hold proper gage on this curved route.

Moffat Tunnel Subdivision (Figure 12)

(Before) **(After)**

Similarly, when we replace aging bridges on our system, we typically use materials that are more durable than those used in the original construction. We replace timber with steel and concrete. We also build the new bridges to accommodate expected growth in freight volumes. Union Pacific has over 400 miles of bridges, so bridge replacements are an expensive proposition, but they are the type of major investment in infrastructure we can now make so that we provide more reliable, efficient service.

Concrete Bridge – Sacramento, California (Figure 13)

As a result of these investments in replacement capital, Union Pacific is a much more robust railroad than its components were at the time of the Union Pacific-Chicago & North Western and Union Pacific-Southern Pacific mergers. That lets us provide better service.

C. Investment in Locomotives and Freight Cars

Union Pacific has also used improved revenues to acquire new locomotives and freight cars. Since 1999, we have invested more than $6.7 billion to replace older equipment at the end of its useful life and position the company to handle growing customer volumes. For example, we have acquired, on average, 279 new road locomotives for our fleet each year since 1999. Our new locomotives are more fuel efficient and produce fewer emissions than older locomotive units. Over 75% percent of our locomotives are certified under existing EPA emission standards.

D. Investment in Technology

As our revenues have grown, investments in technology have played a critical role in improving our service and increasing our effective capacity. In our quest to improve service, Union Pacific is investing in technology that reduces interruptions to the flow of trains and, as a result, makes our service faster and more reliable.

Harriman Dispatch Center (HDC) (Figure 14)

Many of the actions we are taking deal with problems that have affected the industry for more than a century, but were treated as unavoidable aspects of operating a railroad. Union Pacific risks unplanned interruptions – a locomotive failure, a train splitting apart, a false reading on a wayside defect detector, and many other events. Every one of these interruptions potentially stops one or more freight trains, usually delays other trains, causes crews to be on the road longer than planned, and disrupts the reliability of our customer service. Here are several examples of what we are doing about this situation.

Locomotive health diagnostics. Modern diesel locomotives contain sophisticated, computerized monitoring systems that transmit numerous reports on non-standard operating conditions. Union Pacific has developed a unique system that accumulates and analyzes the reports on each locomotive as it operates throughout the system. When the locomotive reaches a repair or servicing facility, our system tells mechanical forces exactly what needs to be looked at and precisely how to repair it, saving time in the shop. As a result of this system, we improved the mean time between locomotive failures on our premium trains by 20 percent in one year.

Reducing derailments caused by defects. Over the last decade, Union Pacific has installed a battery of technological innovations to catch defects before they become derailments. In 2002, we and other railroads began installing "WILD" wheel-impact detectors. These detectors identify individual wheels that have imperfections and produce unusual impacts on the rail. The WILD detectors are linked by communications and computer systems, so that we can

monitor the evolution of each individual wheel. As a wheel approaches a point where it could cause a derailment or damage rail, we proactively fix it.

Wheel Impact Load Detector (WILD) (Figure 15)

In 2004, we also installed acoustic sensing devices that "hear" signs of a wheel bearing failure before it can cause a derailment.

At North Platte, we created a one-of-a-kind, automated facility to perform ultrasonic testing of individual wheels to look for defects that visual inspection cannot find. Using this system, we have located 93 defective wheels, each of which would likely have derailed a train. An entire train can operate through the testing system at 5 miles per hour and then proceed toward its destination. We have "scrubbed" the coal-train fleet on Union Pacific and are now moving on to other types of unit trains. Union Pacific has not suffered a shattered wheel-caused coal train derailment in two years, a major improvement. This is an example of our ability to

innovate because of the size and strength of the railroad. It is unlikely that one of our smaller predecessor railroads could have dedicated resources to this kind of innovation.

Ultrasonic Wheel Defect Detector (Figure 16)

Reducing derailments caused by equipment is only part of our campaign. We also have deployed state-of-the-art technology to identify defects in rail that can cause derailments or delays due to broken rails. Our suppliers perform tests on all new rail, but defects can nevertheless slip by, and they are not visible. Union Pacific has deployed sophisticated rail detector cars that use ultrasonic and induction technology to look inside rails for hidden defects. These cars can operate at speeds from 10-15 miles per hour.

depending on the technology used, so we can inspect big segments of the railroad quickly and repeatedly.

EC-5 Track Evaluation Car (Figure 17)

A related area in which investment in technology is helping to maintain network fluidity is our investment in the most modern, efficient track maintenance equipment. For example, our TRT 909 track renewal train installs new rails and concrete ties in one pass, and can install up to 6,000 ties plus new rail in a ten-hour day. Moreover, by using this equipment we can

undertake the extensive renewal projects that are necessary to maintain and upgrade our service while minimizing disruption to traffic that must continue to move over our network.

Track Renewal Train (Figure 18)

Another area in which technology has played a critical role in improving service has been the development of advanced information systems, such as our Customer Inventory Management System, or "CIMS." We developed CIMS to help proactively manage terminal inventory, in order to maintain terminal fluidity and increase asset utilization. CIMS monitors customer railcar inventory and storage capacity, freight cars en route on Union Pacific, and freight cars awaiting final delivery to customers. It allows us to help customers manage traffic flows and avoid delays. It therefore helps reduce terminal inventory and dwell time and improve switching performance. If cars arrive using reciprocal switching or terminal trackage rights, we would lose the ability to adjust the flow into terminals to protect fluidity.

Still another significant example of technology investment is expanding the number of locomotives that are equipped to operate using distributed power. Use of distributed power – placing additional locomotives at intermediate points in, or on the end of, a train and controlling them from the lead locomotive – lets us operate fewer, longer trains to deliver the same amount

of freight. In addition, distributed power reduces failure rates because distributing the motive power throughout the train reduces forces that can cause damage to draw bars and shipments. We also save fuel and improve rail life because distributing the motive power reduces friction between wheels and rail on curves. We used distributed power to move 62 percent of our gross ton miles in 2010, up from 26 percent of gross ton miles in 2007. If shippers could dictate the interchanges that we use, thus fracturing our traffic across a wide variety of routings, we would need to operate more, smaller trains, and the efficiencies we have gained by using distributed power to create longer carload trains would be lost.

E. Transportation Planning

Union Pacific's transportation plan, which is our "playbook" for train operations is called the "Unified Plan," and it is a living playbook. The Unified Plan reflects an ongoing effort that we began in the second half of 2004, when we took a "clean sheet" approach to designing plans for all types of train service. Using this process, we have since 2005 removed 39 percent of work events and reduced the number of switch events by 21 percent. Because capital planning requires starting three years before an investment is needed, we cannot respond to frequent and unplanned shifts in routing. Our planning process will be far less effective and produce poorer service if shippers can introduce work events and switch cars to less efficient routes and interchanges.

APPENDIX B

APPENDIX B: PLANNED INVESTMENT IN A STABLE REGULATORY AND ECONOMIC ENVIRONMENT

Union Pacific has publicly told investors that they can expect us to bump up capital investment in coming years if demand for the service grows and regulatory rules remain stable. In the following pages, I will summarize some of the important investment that we want to make.

A. Rail Infrastructure Renewal Needs Capital

As I discussed previously, Union Pacific spends heavily every year to replace the track infrastructure over which we operate. We plan to continue reinvesting capital in our existing infrastructure at a rate of approximately $1.6 billion to $1.7 billion annually. Especially since the Union Pacific-Southern Pacific merger, we have focused heavily on tie replacement to bring the railroad into a regular cycle for ties. With more than 90 percent of our core mainline routes now in tie cycle, we are focusing more of our capital on renewing mainline rail, bridge replacement, and upgrading yards and industry lead tracks. The history of Southern Pacific's deteriorated service due to lack of resources to maintain track, and the years and billions of dollars required to restore that infrastructure, underscore the importance of our commitment to capital maintenance.

In 2011, we expect to replace approximately 4.2 million ties and relay about 1,000 miles of rail, including yard and industry lead tracks. We will continue a robust bridge-replacement program, spending about $127 million. Our replacement programs will be especially extensive this year on the railroad's Southern Region. Our aggressive work plan has had a modest impact on service in that region during early 2011, which will continue through the summer.

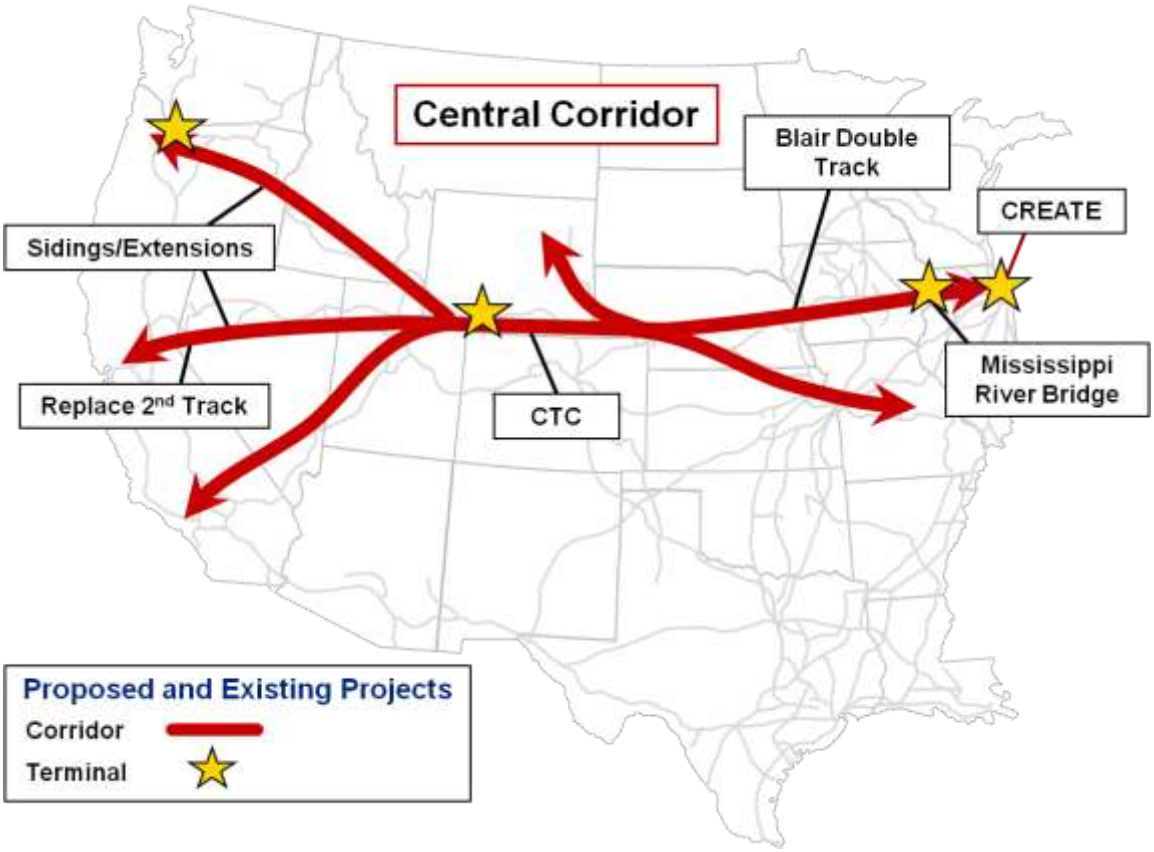
B. Capacity Expansion Projects

Union Pacific wants to increase our investments in new capacity. In 2011, we expect our capacity investments, broadly defined to include all investments except PTC and replacements of assets, to increase by about 72 percent above 2010 levels, to over a billion dollars. We expect

that higher amount to continue to grow modestly over the next few years. I will provide an overview of how we now foresee investing capacity dollars in the coming years, if legal or regulatory directives do not undermine our plans, and how those investments would help us improve service to our customers. Loss of revenue and loss of control over routing decisions would put these projects in jeopardy.

Central Corridor. The following map shows our major capacity projects in this corridor, which I will describe in more detail below.

Central Corridor Capacity Projects (Figure 1)



In the Chicago area, in addition to the CREATE projects that I described earlier, we are working in a public-private partnership with METRA to ensure passenger safety while improving METRA train and freight train reliability. We share our Geneva Subdivision from Chicago west beyond Geneva, Illinois, with METRA commuter trains. We are collaborating

with METRA on a major project, costing well over $100 million that includes adding new protections for METRA passengers at stations along the route, new crossovers between tracks, and new sections of third main track. As segments are completed, Union Pacific will be able to operate freight trains during rush hours under specified conditions, eliminating multi-hour morning and evening windows when freight trains have to wait outside the corridor. These windows have been a major thorn in the side of freight service reliability, because even a slight delay to a freight train anywhere in the West can cause the train be held outside Chicago for the METRA curfew and delay shipments for several hours.

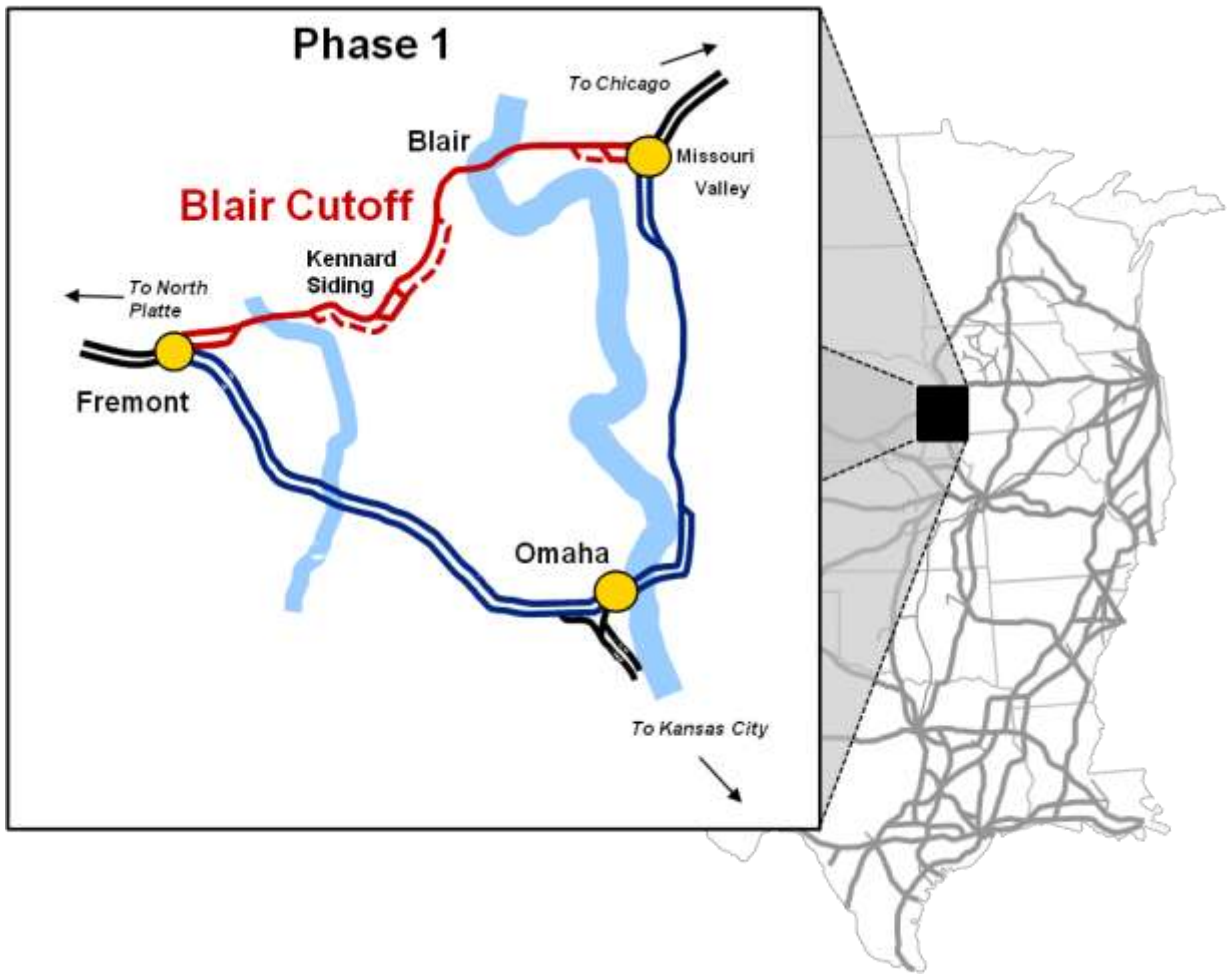
Further west, Union Pacific will be launching a project costing almost $400 million to build a new Mississippi River bridge at Clinton, Iowa. An artist's rendering of the proposed bridge is shown below.

(Figure 2)

Unlike today's bridge, which includes a swing span that must be opened for passing barges and pleasure craft for hours per day in season, the new bridge will be high enough to allow river traffic to pass unimpeded.

Continuing west, we reach a major capacity expansion that is under construction today. As shown on the following map, Union Pacific tracks form a triangle in eastern Nebraska and western Iowa.

Blair Cut-Off (Figure 3)



The shorter, more direct route of the former Chicago & North Western between Missouri Valley, Iowa, and Fremont, Nebraska, is primarily single-track, so we do not have enough capacity to handle 70 or more Central Corridor trains per day on the shorter route. We run most westbound trains over the direct route and most eastbound trains via the longer route through Omaha.

We are now constructing a second main track between Fremont and Blair, Nebraska, double-tracking most of the shorter route. This $260 million project will allow us to save 25 miles for dozens of trains daily. More importantly, because of congestion and track

configurations in the Omaha/Council Bluffs area, the project will save each of those trains two to four hours, reducing transit times and making transportation more predictable.

Moving further west, we will continue to add CTC to the original transcontinental mainline in southern Wyoming, ultimately extending CTC's reach all the way from Chicago into western Wyoming. In northern Nevada, where we have the two routes (Donner and Feather River, discussed earlier), the Donner route will get a new siding and longer sidings to permit us to run longer trains all the way between Chicago and northern California.

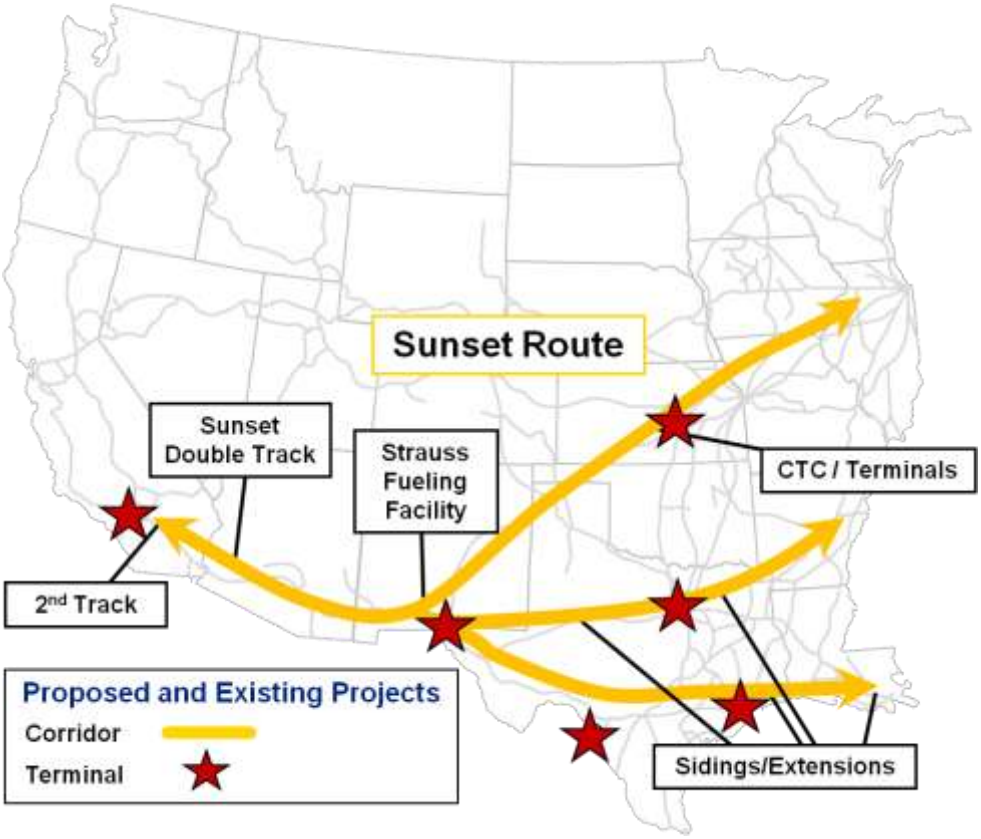
At the top of Donner Pass, where the cash-strapped Southern Pacific removed a portion of its second track over the Sierra Nevada Mountains, Union Pacific plans to replace that track to increase capacity on this more direct route. Also in California, our Lathrop intermodal facility, south of Stockton in the Central Valley, has been very attractive to domestic shippers. We are expanding it this year, and we will need to expand it further, a project costing almost $90 million.

Branching northwest from the Central Corridor in western Wyoming, Union Pacific's route to Portland and Seattle is a major trade route, with ocean-going containers moving east, and grain, coal, and soda ash moving west. It also carries a large volume of carload traffic, and will carry even more when the housing market recovers and forest product traffic returns.

Union Pacific is presently extending sidings and adding terminal tracks along this route to increase reliability and allow us to operate longer trains. We will continue to do both. We will also expand our intermodal terminal in Portland. We plan to add an expensive connection in central Portland to allow trains to move directly between our east-west routes and our North-South I-5 Corridor along the West Coast.

Sunset Corridor. The following map shows the many projects we have planned for this corridor, which I will describe below.

Sunset Corridor Capacity Projects (Figure 4)



Beginning at the California terminus of this corridor, Union Pacific plans to add capacity at its domestic intermodal facilities at Los Angeles Transportation Center and East Los Angeles, at a cost of over $100 million. Near the Ports of Los Angeles and Long Beach, we have been pursuing environmental clearance for years to upgrade our Intermodal Container Transfer Facility – an upgrade that, if permitted, will significantly reduce emissions. The first phase would be to add a new gate complex that would substantially reduce waiting time for trucks entering the facility.

Between Pomona, California, and West Colton, California, we plan to install double-track in segments, completing the project by 2014. This will reduce conflicts between Union

Pacific and Metrolink and BNSF trains on our other route through the Los Angeles Basin, improving reliability for all of us. A major project, which Union Pacific will help fund, will begin construction soon at Colton, where BNSF's Transcon Route crosses Union Pacific's Sunset Route at the busiest rail crossing in the West. This public-private-partnership project will elevate Union Pacific's double-track over the BNSF, eliminating significant freight train delay, improving freight movement to and from the ports, and protecting the reliability of Metrolink and Amtrak passenger service.

Our largest Sunset Route project continues, as we adds more second main track across the corridor between Southern California and Tucson. We expect to add 53 miles this year, bringing the route to 68 percent double track. We want to pace expansion ahead of anticipated demand for our services.

We accomplish little if we hustle trains across the Sunset Route but cannot get them through El Paso, the major bottleneck on this route. We have substantially improved train processing through this congested terminal, but there is no room to add more tracks. As a result, this month we authorized construction of a $400 million terminal west of El Paso, which we call Strauss but most people call Santa Teresa. This terminal will include refueling facilities (supported by a new pipeline from El Paso), a rail yard where trains to and from West Coast ports can be sorted for destinations throughout the corridor, and a new intermodal facility serving the El Paso area.

On the most southerly route, east from El Paso to New Orleans, Union Pacific and BNSF serve a rapidly growing gateway to Mexico (Mexican rail traffic has fully recovered from the recession) at Eagle Pass, Texas. We need to improve the connection on the Sunset Route at Spofford, Texas, add sidings en route to the border, and expand switching capacity near Eagle Pass, a project already underway.

We plan to improve capacity and fluidity in the San Antonio corridor, adding second main track and additional crossovers between tracks. Our single-track Glidden Subdivision connecting San Antonio to Houston is at capacity today. We will add second track and extend sidings to improve fluidity and reduce delays. A second main track is especially important at the east end, between Rosenberg, Texas, and Houston, where we share tracks not only with Amtrak's New Orleans-Los Angeles trains, but also with Kansas City Southern and BNSF. And we plan further improvements to our Houston terminal trackage to reduce delays and increase capacity.

At the eastern end of this corridor in Louisiana, our line between our yard at Livonia (near Baton Rouge) and New Orleans is at capacity and must be expanded. Traffic to and from this heavily industrialized corridor continues to grow, with crude oil now arriving from North Dakota, more export grain, and increasing chemical shipments. We plan to construct support tracks to take our local trains off the mainline while they serve customers and second main track for through trains to and from the New Orleans gateway.

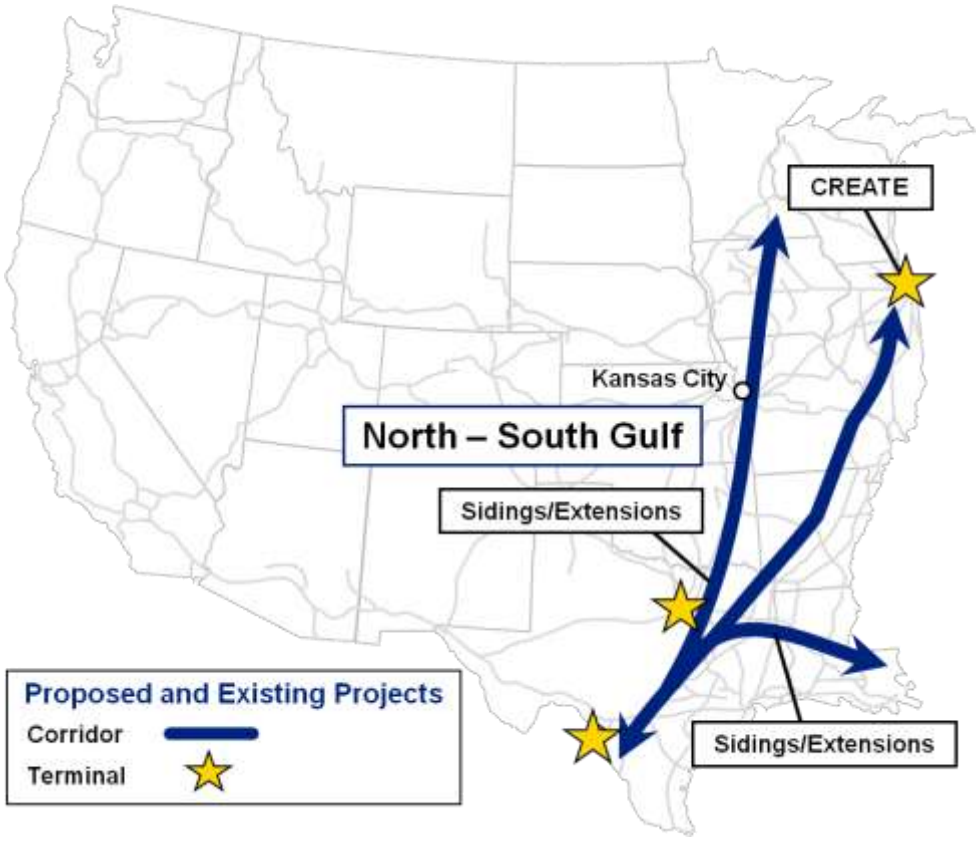
The former Texas & Pacific route from El Paso to Ft. Worth, now handling 18-23 trains per day, should handle more in the future if traffic patterns are not disrupted. Each year, we plan to extend three or four sidings along the route. Each time we do, we will be able to add an additional pair of longer, more efficient trains. At Ft. Worth, we are reconfiguring our major rail yard, Davidson Yard, in a public-private partnership that will add two main tracks between the yard and the busiest rail crossing in Texas, at Tower 55. A public-private partnership to expand capacity at Tower 55 has been funded and is awaiting approval.

Our line from El Paso to Kansas City includes a segment of single-track without CTC between Pratt and Herington, Kansas. When trains meet, employees must detrain to move hand-thrown switches, and dispatchers must use less efficient systems for train control. We plan to

add CTC across this segment. We will also add terminal capacity for through trains at crew-change points such as Dalhart, Texas, and Herington.

North-South Corridor. Union Pacific also has plans for capital spending in its North-South Corridor, as the following map illustrates.

North-South Corridor Capacity Projects (Figure 5)



We plan to add capacity at a number of points in this corridor in coming years. We will add track north of Ft. Worth and in the Denison, Texas, area to improve fluidity. We will begin installing CTC on what we call our Van Buren Subdivision, which carries trains between Little Rock and eastern Oklahoma.

On the Trenton Subdivision, which connects Kansas City and Des Moines, significant traffic growth – especially in ethanol, crude oil, and agricultural products – has outstripped capacity. As a result, we operate some northbound trains hundreds of miles out of route via

Omaha to make room for southbound trains on this route. As we add capacity on the Trenton Subdivision, we can turn those trains back to the most direct route.

Locomotives and Rail Cars

Although our locomotive fleet is the youngest in history, we will need to replace 100 - 200 road locomotives per year just to maintain quality. At over $2,000,000 per copy, that investment will require more than $400 million annually. We will need to invest even more to rebuild or replace local and switching locomotives.

In addition, we routinely have about 250,000 freight cars on our system, not including cars in storage. Of course, shippers own many of those cars, especially to transport coal, and TTX owns the majority of the intermodal cars on our railroad. To maintain the current carrying capacity of those rail cars, many of which are approaching the end of their lives, requires the renewal of several thousand cars per year. Union Pacific will continue to invest in freight cars, especially covered hopper cars for agricultural and other bulk commodities, and auto-carrying cars, and intermodal containers and chassis. We are evaluating replacements for other car fleets, but those investments – like all investments – will depend on the expected return on capital from each investment.

Positive Train Control

Our capital spending on PTC is ramping up this year, when we expect to invest roughly $250 million in system development and pilot programs. We expect to continue to invest at that level or higher in coming years. We have no choice but to make these investments, although we have made it clear to government officials that we already have made, and will continue to make, greater improvements in safety for far less cost. PTC diverts capital from capacity, freight cars, and locomotives. It adds costs to rail service, both by consuming capacity and by substantially increasing operating costs as far into the future as we can see.