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November 17, 2000

ENTERED
Office of the Secretary

NOV 17 2000

Part of
Public Record

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW, Suite 715
Washington, DC 20423-0001

Re: Ex Parte No. 582 (Sub-No. 1)
Major Rail Consolidation Procedures -- Notice of Proposed Rulemaking --
Comments of The Kansas City Southern Railway Company

Dear Secretary Williams:

Enclosed for filing are the original and twenty-five copies of the Comments of The Kansas City Southern Railway Company on the Notice of Proposed Rulemaking issued by the Surface Transportation Board in *Major Rail Consolidation Procedures*, Ex Parte 582 (Sub-No. 1). Also enclosed is a 3.5 inch diskette formatted for Word Perfect containing a copy of this filing.

Please time and date stamp the extra copy of the Comments and return it with our messenger.

Please feel free to contact me if you have any questions.

Very truly yours,



Thomas J. Healey

Enclosures

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

NOTICE OF PROPOSED RULEMAKING

**COMMENTS OF THE
KANSAS CITY SOUTHERN RAILWAY COMPANY**

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November 17, 2000

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

NOTICE OF PROPOSED RULEMAKING

**COMMENTS OF THE
KANSAS CITY SOUTHERN RAILWAY COMPANY**

Introduction

The Kansas City Southern Railway Company (“KCS”), by its counsel, hereby provides the Surface Transportation Board (“STB” or the “Board”) with its Comments on the Notice of Proposed Rulemaking (“NPR”), served October 3, 2000, in *Major Rail Consolidation Procedures*, Ex Parte No. 582 (Sub-No. 1).¹ The *NPR* manifests a fundamental policy shift away from a policy promoting rail mergers toward a policy of preservation and enhancement of competition. In proposing this policy shift, the Board is doing more than simply “raising the bar” on major rail mergers, as has been suggested elsewhere. The *NPR* goes much further, reaffirming the dynamic and beneficial role played by competition in the rail marketplace.

¹ In response to the Board’s “Advance Notice of Proposed Rulemaking” (*Major Rail Consolidation Procedures*, Ex Parte No. 582(Sub-No. 1), STB served March 17, 2000 (“*ANPR*”)), KCS filed comments with the Board on May 16, 2000 (“*ANPR Comments*”).

KCS applauds the Board's efforts to revise its merger regulations. The existing regulations, which are heavily weighted toward the approval of mergers as negotiated by the applicants, are a product of a different age. When the existing regulations were promulgated almost twenty years ago, overbuilt rail franchises sought refuge in mergers to shore up negative returns on capital. More recent rail mergers have focused on expanded market reach and increased service opportunities. KCS agrees with the Board that, in light of these changes, the focus of new merger regulations should be on the preservation of competitive rail options, including the enhancement of such competition when necessary to preserve competitive rail alternatives available to shippers.

KCS supports the preservation of rail competition, as well as the enhancement of rail competition, if such enhancement is needed to remedy anticompetitive effects of any past or future merger. KCS does not, however, believe the Board should impose competition-enhancing conditions that are not related to remedying specific competitive harms created by rail mergers and their associated crossover and cumulative effects. As many other parties have indicated in this proceeding, if a restructuring of the non-merger related, competitive environment of the rail industry is warranted, such a restructuring should be made by Congress and should have uniform application throughout the entire rail industry. The Board should not use a merger (or the regulations under which mergers are approved) as a means of imposing non-merger related changes in the structure of the railroad industry. Similarly, changes such as reopening or reconsidering the *Midtec* doctrine (*Midtec Paper Corp. et al. v. Chicago and N.W. Transp. Co. (Use of Terminal Facilities and Reciprocal Switching Agreement)*, 3 I.C.C.2d 171, 173-174 (1986), *aff'd*, 857 F.2d 1487 (D.C. Cir. 1988)) or reversing the Board's bottleneck decision (*FMC Wyoming Corp. v. Union Pac. R.R. Co.*, Finance Docket No. 33467 (STB served Dec. 16, 1997)),

aff'd Union Pac. R.R. Co. v. STB, 202 F.3d 337 (D.C. Cir. 2000)) need to be addressed, if at all, in the context of a separate *Ex Parte* proceeding.

While the Board's revised merger regulations will more appropriately address the issues presented in a modern rail merger, KCS has concerns over the lack of specificity in some of the proposed rules. For example, the general discussion of the need to preserve and enhance competition (found in Sections 1180.1(c) and 1180.6(b)(10)) does not adequately focus on the fact that the Board is charged with protecting the public interest in preserving rail-to-rail competition. The proposed rules' general wording does not provide enough clarity and specificity. Markets work best when the rules are clear and concise and the "regulatory costs" can be assessed accurately by the market place. Market participants cannot make such a judgment under the proposed rules. Indeed, merging parties likely will not be able to determine with any certainty how these rules will impact the approval and conditioning of rail mergers until the Board has processed several transactions under the new rules. Unnecessary vagueness will handicap merger applicants in negotiating and presenting for approval appropriate merger proposals. KCS' comments will focus on increasing the specificity of the rules so they may provide better guidance.

1180.0 - Scope And Purpose

KCS offers no comment on the revisions to this existing rule as proposed by the Board, as the proposed changes simply amend the rule to reflect changes made elsewhere to the regulations, and do not, by themselves, create any substantive modification to the rules. However, KCS believes that the Board should use this opportunity, while revising this section, to reflect on the proposition that a merger of a smaller Class I railroad (one with under \$1 billion in

annual revenues) with a larger Class I carrier does not warrant treatment as a “major” transaction, but instead may be appropriately processed under the Board’s more modest “significant” merger standards so long as the proposed transaction is not hostile.

As explained in greater detail in KCS’ *ANPR Comments*, the existing structure of the rail industry clearly justifies the disparate treatment of large and small Class I railroads in merger proceedings. The six largest Class I carriers all stretch from Chicago and other Mississippi Valley-area terminals to multiple ocean ports, with numerous secondary and branch lines providing extensive market coverage and substantial leverage in rates and divisions. By comparison, KCS and several large Class II carriers that might soon qualify as Class I railroads (such as Wisconsin Central Ltd., Montana Rail Link, and Florida East Coast) compete with and complement the largest Class I carriers in select markets, but possess none of the market reach of the larger carriers. Currently, seven railroads qualify as Class I carriers.² They are listed below, along with their operating revenue for 1999:³

Union Pacific Railroad	\$ 10.2 billion
The Burlington Northern and Santa Fe Railway	\$ 9.1 billion
CSX Transportation, Inc.	\$ 5.6 billion
Norfolk Southern Corporation	\$ 5.2 billion
Canadian National Railway (including Illinois Central)	\$ 3.5 billion
Canadian Pacific Railway	\$ 2.4 billion
The Kansas City Southern Railway Company	\$ 519.2 million

The disparity between the largest and smallest Class I carriers can also be measured by total track miles:

² The data below reflects railway operating revenue and track miles based upon consolidated figures for parent and wholly-owned rail subsidiaries.

³ In U.S. dollars. Canadian dollars were converted using the May 1, 2000 exchange rate of 1.4783 Canadian dollars per U.S. dollar.

Union Pacific Railroad	33,705
The Burlington Northern and Santa Fe Railway	33,500
CSX Transportation, Inc.	23,400
Norfolk Southern Corporation	21,800
Canadian National Railway (including Illinois Central)	15,777
Canadian Pacific Railway	14,358
The Kansas City Southern Railway Company	3,718

As these figures amply demonstrate, KCS bears very little resemblance to the remaining Class I carriers. With appropriate consent, the merger of such a consenting small Class I railroad with one of the larger Class I carriers simply does not have the competitive impact found in the merger of the nation's largest railroads, and thus does not justify treatment as a "major" transaction.

The Board's recent proposal to require consolidated financial reporting by commonly controlled railroads (*Consolidated Railroad Reporting*, Ex Parte 634 (STB served September 25, 2000) ("*Reporting*")) strongly supports the exclusion of smaller Class I carriers from the "major" merger category. In *Reporting*, the Board indicated that it might adopt Financial Accounting Standards Board Statement No. 94, *Consolidation of All Majority-owned Subsidiaries* (1987) ("FASB 94"), which would require that railroads consolidate the reporting of financial information for all majority-owned and controlled subsidiaries. Adoption of FASB 94 by the Board would hasten the process by which larger Class II carriers move into the Class I ranks, and would greatly increase the number of potential "major" mergers under the Board's merger regulations. The potential adoption of FASB 94 by the Board provides yet another reason for the Board to reduce the merger of consenting small and large Class I carriers to "significant" status.

Section 1180.1(a) - General Policy

KCS supports the Board's efforts to refocus its merger policy on the enhancement of rail capacity and competition as remedies to combat the anticompetitive effects of past and future mergers, but believes that the policy should be more specific. In particular, KCS believes that the Board's opening statement of its general merger policy should leave no doubt that the preservation of rail-to-rail competition is the single most important factor examined by the Board in weighing the merits of a proposed rail consolidation. Assessments of the public benefits to be bestowed by a rail merger necessarily hinge on the degree to which competitive options to shippers will be preserved by proposed combinations. Although matters of rail safety and service (addressed elsewhere in the Board's *NPR*) are also of importance to the merger approval process, it is difficult to imagine the approval of a merger which adequately addressed matters of safety and service but which allowed any significant reduction in the competitive rail service options available to specific shippers prior to the proposed merger.

In many prior rail merger proceedings (and, most notably, in *Union Pac. R.R. Co. et al. – Control and Merger – Southern Pac. Rail Corp. et al.*, Finance Docket No. 32760 (STB served Aug. 12, 1996)), KCS has disagreed with the Board and its predecessor as to what level of reduction in competition merited remediation. Over the last ten years, relief has generally been limited to situations where competitive options were reduced from 2-to-1, a situation which by definition eliminates competition. By contrast, KCS traditionally has urged the Board to provide a remedy for harms arising from 3-to-2 and other reductions in competition. KCS believes that the *NPR* eliminates much of the disagreement between KCS and the Board regarding what constitutes harm requiring remediation. The *NPR*, and, more particularly, the policy statement

contained in Section 1180.1(a) will serve to protect shippers from reductions in competition from both past and future mergers.

Two aspects of the Board's proposed merger policy statement deserve comment. First, the Board must beware that its focus on balancing competition⁴ may in fact serve to reduce competition. Rather than preserving rail options currently available to the shippers, the Board's policy may actually force the industry too quickly down the path toward consolidation to only two Class I carriers. Many parties to this proceeding have commented on the effects that recent mergers have had in propelling additional downstream mergers between the original merging carriers' competitors. The merger of Union Pacific and Southern Pacific was a response to the Burlington Northern-Santa Fe merger, while the division of Conrail responded to these two western mergers. There is a danger that if the Board weighs too heavily on the creation of competitors of equal size in its calculus of public benefits, the Board will force, rather than control, the consolidation of the industry down to two North American Class I carriers, all under the guise of approving one merger because doing so is required to counter balance the effects of another previously approved merger.

As the Board's policy statement recognizes, the rail network is exactly that -- a *network* of complementary and competing interests. A headlong rush to consolidation into two Class I systems, propelled by a Board policy of balancing rail-to-rail competition, or enhancing rail competition vis-à-vis truck competition, could have even more severe effects on the national rail network than recent downstream mergers already have had. Witnesses at the Board's Ex Parte No. 582 hearings last March amply demonstrated the significant, uncompensated harms which

⁴ The proposed revision of Section 1180.1(a) states: "[T]he [STB] seeks to ensure *balanced* and sustainable competition in the railroad industry." (emphasis added)

Class I service meltdowns have had on smaller connecting carriers who lack the routing alternatives or, in some cases, the contractual right to circumvent a gridlocked Class I connection. Should the Board focus too heavily on balancing competition among the ever-increasingly large Class I railroads, it risks the possibility of damaging the rail network as a whole in a way from which it may never recover. Indeed, the evidence in this proceeding does not support the notion that a “balanced,” two carrier rail network would remain in the public interest.

The second aspect of concern to KCS involves the generality of the policy statement. This generality could distort the proper focus, which should be on remediating the adverse effects resulting from any reduction in intramodal competition. The Board’s general policy statement begins with the correct focus: “To meet the needs of the public and the national defense, the Surface Transportation Board seeks to ensure balanced and sustainable competition *in the railroad industry.*” (Emphasis added.) The policy statement thereafter diverges, however, into a discussion of the nation’s overall transportation infrastructure - ports, pipelines, highways and airports - and says that the Board welcomes initiatives “that enhance the capabilities and the competitiveness of *this transportation infrastructure.*” (Emphasis added.) However, the Board’s regulatory authority with respect to modes other than rail is extremely limited. *See generally* 49 U.S.C. §§13501 and 13521. Should the Board allow itself to be distracted by issues of intermodal competition, either as an alternative to or as a substitute for intramodal rail competition, the Board will lose focus on that which its rail merger decisions most directly affect - railroads and rail shippers - thereby abandoning the Board’s primary responsibility. By controlling and preserving intramodal rail competition - real competition demonstrated by market share data - the Board will indirectly foster or preserve competition in other modes which tie into

the rail system. But focusing rail merger decision-making on competition with other modes is a distraction which the Board cannot afford when the number of remaining Class I carriers is so small and the stakes at risk when any of them merge are so great.

1180.1(b) - Consolidation Criteria

KCS supports the Board's proposed revision of the basic statement of merger criteria. For example, the existing regulation's archaic focus on the "total fixed charges that would result" from a merger reflects a concern that is of less importance today than it was twenty years ago. The revised regulation, citing effective competition first, but also listing safety, service, environmental concern, and labor issues, provides the proper balance for the current rail merger environment.

1180.1(c) - Public Interest Considerations

KCS generally supports the Board's *NPR* proposal on public interest considerations. However, KCS believes that the requirements with respect to enhancing competition are unnecessarily broad. In the *NPR*, the Board proposes to make a giant leap from its traditional position of preserving competition to one of enhancing competition. KCS supports the emphasis on preserving competition but does not believe the rules should be used to fundamentally restructure the rail industry beyond what is necessary to remediate anticompetitive effects flowing from a merger. In past rail mergers, the Board has only selectively preserved competition by protecting only those situations where a shipper's rail options were eliminated through a 2-to-1 reduction. Traditionally, the Board has declined to provide protections that would preserve competition for shippers going from 3-to-2 rail options after a rail merger. In the

NPR, however, the Board proposes to mandate that any future mergers should enhance competition beyond what already exists.

KCS believes that the Board's chief guiding principle in any future merger proceeding should be to preserve the level of pre-merger rail service options available to shippers. To this end, it is especially important for the Board to give increased consideration to the harmful competitive effects caused by any reduction in the number of rail competitors serving a particular market, such as 3-to-2, 4-to-3 or 5-to-4 situations. Under the Board's prior merger standards, granting relief in 3-to-2 situations was viewed as unnecessary to preserve competition, and thus conditions were generally not imposed in such situations. In its *ANPR Comments*, KCS proposed a rule to modify the Board's public interest considerations to clarify that preservation of all competitive intramodal options should be codified for future mergers. *See ANPR Comments* at 5-18 and Exhibit A. KCS' proposed modification would provide the public interest test with the proper balance by ensuring that shippers do not lose any rail service options.

In contrast, the Board's *NPR* expands the public interest consideration beyond preserving the competitive rail options that already exist. The Board's proposal would require applicants to manufacture non-remedial competition in the rail merger process outside of ameliorating competitive harms. In addition, the Board's proposal appears to require applicants to propose measures designed to enhance rail-to-rail competition that are not even related to a particular adverse consequence of a proposed merger. The Board's proposal would encourage manufacturing of non-remedial competition in one area to offset or balance competitive harms in a completely different area or even to offset harms that may occur from transitional service disruptions. The Board's proposal even goes beyond what normal antitrust laws would dictate since the Board's proposal would artificially discourage mergers and require applicants to proffer

enhanced competition that is not aimed at ameliorating a specific harm of the proposed transaction.

KCS believes that the Board should focus on preserving and enhancing rail competition and remedying the anticompetitive effects of rail mergers, particularly with an emphasis on preserving rail-to-rail competition. This can be accomplished by narrowing the Board's public interest considerations proposal in the *NPR* to reflect something similar to KCS' proposal in its *ANPR Comments* which would preserve all rail service options, such as 3-to-2, that would be, or have been, lost in a rail merger. KCS' proposal would provide a definitive benchmark that both shippers and railroads would be able to calculate in determining whether to undertake a merger or assess the impacts of a proposed merger.

The proposal that KCS made in its *ANPR Comments* would also alleviate the speculative and possibly contrived proposals that might develop from attempts at meeting the Board's enhanced, non-remedial competition requirement. In approving a rail merger, the Board should insure that shippers have all of their pre-merger rail-to-rail competitive options preserved. The Board's proposed mandate for enhanced, manufactured, non-remedial competitive options could have the negative impact of discouraging any future mergers, even if the merger preserved all current rail-to-rail competition, improved service and provided efficiency gains. KCS' proposal provides the requisite balance between shippers and railroads in the public interest consideration.

In addition, KCS supports the Board's proposal to consider whether any of the claimed merger benefits could be realized by means other than the proposed transaction. *See ANPR Comments* at 18 - 20. KCS supports the Board's recognition that many merger related benefits can be achieved through private agreements short of a merger. The Board should continue to support private sector agreements, such as joint marketing agreements and interline partnerships,

that often produce merger-like benefits without the commensurate potential harms to the public sometimes generated by rail mergers.

1180.1(c)(1) - Potential Benefits

KCS agrees that the Board should require applicants to carefully calculate the net public benefits that any proposed merger will generate. The best way for applicants, the Board, and the public to calculate the benefits of a proposed merger is for there to be full disclosure of all the aspects affecting or being affected by the merger. KCS' *ANPR Comments* proposed several ways for the Board and the public to obtain full disclosure of both the potential benefits and harms of a merger. For example, KCS proposed that the Board should require applicants to submit copies of all settlement agreements entered into between applicants and any party with an analysis of the impact that settlement would have on the proposed transaction. *ANPR Comments* at 44 - 54. This modest procedural change would enable the Board to make a more fully-informed evaluation and decision on the impact of the transaction.

KCS also agrees with the Board's proposal to require merger applicants to propose additional measures that the Board could take if the professed public benefits did not materialize in a timely fashion. To assist the Board in this determination, the Board should require applicants, in their oversight reports, to provide a complete analysis of the actual results that the transaction is achieving compared to the projected benefits that applicants predicted. Applicants should be required to provide the necessary data and substantiated information for the Board to completely and fairly assess the level of realization of the predicted benefits of a merger.

1180.1(c)(2) - Potential Harm

KCS agrees with the Board's proposal that it must be able to fully evaluate the potential harm that a proposed transaction may cause. Several of KCS' proposals in its *ANPR Comments* would assist the Board in this evaluation. The Board could more fully evaluate the potential harm of a proposed transaction by requiring applicants to disclose and justify, in light of the changing competitive circumstances created by the transaction, the paper and steel barrier impediments that prevent shortline and regional railroads from interchanging and competing for traffic. See *ANPR Comments* at 82 - 91. The disclosure of this material would aid in the Board's evaluation of the overall net public benefits as well as aiding the Board's determination of the harm to essential services. KCS agrees with the Board's proposal in Section 1180.1(c)(2)(ii) to assess the potential harm a merger may have on various rail network links, including Class II and Class III carriers. A merger may limit the competing routes available to shortlines and thereby potentially harm essential services. Requiring the disclosure of paper and steel barriers and then allowing the Board to remove or modify those barriers that are inconsistent with the public interest, in the context of a merger, would ensure a complete evaluation of the public benefits and harms of a proposed transaction.

Another proposal that KCS made in its *ANPR Comments* which would also assist the Board in its evaluation of the public benefits consideration by providing additional information to the Board. The Board should require applicants to disclose any facility, station, or terminal that had been closed to reciprocal switching by any of the applicants within 24 months prior to the filing of the notice of intent to merge pursuant to 49 C.F.R. Section 1180.4(b). *ANPR Comments* at 54 - 64. KCS' proposal would ensure that the Board could make a complete

evaluation of all rail-to-rail competitive options that a shipper had prior to the merger that would otherwise be lost.

1180.1(d) - Conditions

KCS believes that the revisions proposed by the Board to this regulation go a long way toward modernizing and improving the use of the Board's traditionally broad conditioning authority for approving mergers. The existing regulation was clearly outmoded, particularly in its reference to the use of conditioning authority "to protect a carrier." Such notions no longer comport with the Board's increasing emphasis on the preservation and enhancement of competition, and not of competitors.

KCS supports the Board's limitation of the use of the power to condition to address only those harms arising from merger transactions. The Board is correct to resist the urgings of parties seeking to use the merger review and approval process to implement wider notions of competitive access or expanded competition outside of that required to address merger-related harms. Because such a startling new use of conditioning authority would directly impact not only the merging carriers, but the rail industry as a whole, the Board has appropriately left such matters to Congress.

While KCS supports the Board's proposed revisions to this regulation, it also believes that several clarifications could significantly further the Board's goals of enhancing and preserving competition. First, in line with the Board's expanded emphasis on preserving all competitive rail options, the Board should add a provision to this regulation stating that the Board will use its conditioning authority to remedy harms to competition resulting from previous mergers involving the current merger applicants. Whether forecast or not, it is undeniable that

certain past mergers have resulted in a loss of rail-to-rail competition.⁵ Such losses do not have to be permanent.⁶ There is no reason why the Board cannot make future mergers conditional on the imposition of conditions designed to remedy past reductions in competition. Such a use of the Board's authority would strike an appropriate balance between those who believe that competition should never be enhanced in a merger and those seeking to use the Board's willingness to enhance competition to reregulate the railroad industry.

At several points in the proposed regulation, the Board refers to the use of conditions to "offset" merger-related harms. KCS believes the Board might wish to consider replacing the word "offset" with "remediate" in its stead. Conditions which "offset" a merger-related harm might be unrelated to the harm (although not unrelated to a merger), whereas conditions which "remediate" a harm are designed to cure undesirable effects. Indeed, the "offset" approach to measuring the impact on the public interest is only viable on the macro level. It is not clear to KCS that a merger which provides increased competition or other benefits to shippers unaffected

⁵ It is very doubtful that the Board would engage in the presumption of unremediable harm from future transactions unless it had implicitly reached the same conclusion. *See NPR*, Proposed Section 1180.1(c), p. 13 (... "the Board believes additional consolidation in the industry is also likely to result in a number of anticompetitive effects, such as loss of geographic competition, that are increasingly difficult to remedy directly or proportionately.")

⁶ KCS is intimately familiar with a situation in which a condition was imposed in a rail merger to remedy the competition lost when a condition imposed in a previous merger was no longer appropriate. In *Union Pac. Corp. et al. – Control – Missouri Pac. Corp. et al.*, 366 ICC 459 (1982) ("UP-MP-WP"), the Missouri-Kansas-Texas Railroad ("Katy") was awarded trackage rights between Kansas City and Omaha to replace competition lost in UP's acquisition of the Missouri Pacific Railroad. However, when UP sought to merge Katy into its system six years later (*Union Pac. R.R. Co. – Control – Missouri-Kansas-Texas R.R. Co.*, Finance Docket No. 30800 (ICC decided May 13, 1988) ("UP-Katy")), the Interstate Commerce Commission ("ICC") determined that the merger needed to be conditioned "in order to preserv[e] the same degree of rail competition in this corridor." *UP-Katy* at 452. Ultimately, the ICC ordered UP to negotiate replacement rights, which UP did with KCS as KCS' "North End Haulage Rights." The replacement condition, it should be noted, was achieved not by reopening *UP-MP-WP*, but by conditioning UP's merger with the Katy upon the negotiation of "North End" rights with an appropriate substitute carrier. *UP-Katy* at 456.

by the merger, while shippers adversely impacted by the merger get no relief, is consistent with the public interest.

Finally, the draft regulation could be substantially improved if the Board reduced the impediments to acceptance of conditions proposed by third parties. If a merger generates anticompetitive effects and will result in a loss of rail-to-rail competition, the Board should not rely exclusively or presumptively upon the remedial conditions proposed by applicants to fully address and redress the harm. Instead, the Board should make a clear policy statement holding that conditions proposed by third parties will be reviewed and assessed under the same standards, and be given the same consideration, as conditions proposed by applicants, to the extent they both address the anticompetitive effects of a merger, and both are operationally feasible. Conditions proposed by third parties are no more “self-serving” than those proposed by applicants, and are therefore equally worthy of the Board’s consideration.⁷

1180.1(e) - Labor Protection

No comment.⁸

1180.1(f) - Environment and Safety

KCS supports the Board’s determination that there is no need to amend the Board’s environmental rules since the Board’s rules implementing the National Environmental Policy Act can be applied on a case-by-case basis to provide the appropriate analysis for a particular

⁷ As drafted, the revised regulation only states that the Board will “carefully consider conditions proposed by applicants...” (emphasis added). 1180.1(d). This should be amended to reflect that careful and equal consideration will be given to conditions proposed by all parties.

⁸ By stating “No comment” here and elsewhere in this filing, KCS does not mean to indicate any implied agreement or disagreement with the Board’s proposed revision to the applicable regulation.

transaction. KCS also fully supports the comments on the environment and safety proposal filed on this same date by the Association of American Railroads. In particular, KCS believes the Board should make it clear that if an agreement cannot be reached, the Board will be available to resolve any disputes under the existing law and precedent. Most importantly, KCS believes that the Board should clarify that it will only consider environmental and safety issues that arise from the proposed merger and that the Board will not address preexisting issues and conditions that are not directly related to the proposed transaction.

1180.1(g) - Oversight

KCS supports the Board's adoption of a regulation setting forth the now-standard provisions of merger oversight. Oversight reporting provides a valuable self-critique, and allows all interested parties to objectively review selected merger results. However, particularly in light of the Board's recent establishment of the Rail Consumer Assistance Program (*see* STB Press Release dated November 2, 2000), KCS believes that the draft regulation would be strengthened with the clarification that parties experiencing merger-related issues do not have to await the quarterly (or annual) public comment period to direct the Board's attention to such issues.

Furthermore, KCS believes that in filing their oversight reports, merger applicants should be required to set forth a matrix that compares their projections contained within the merger application with the actual results. It may not be appropriate in every instance to hold merging parties to their pre-merger projections. It is, however, appropriate to allow all interested parties to determine where the merged parties have fallen short of expectations, and to allow the newly-merged railroad to explain the discrepancy.

Finally, the Board should add a provision to this regulation clarifying that any oversight proceedings which are still open on the date of enactment of this regulation will be subject to the Board's policy directives to enhance and preserve competition. If, as the Board intimates, past mergers have conclusively established that it is inappropriate to limit relief to situations of 2-to-1 competitive reductions, then the Board should exercise its full authority in existing oversight proceedings to fully redress previously unremediated reductions of competition.

1180.1(h) - Service Assurance and Operational Monitoring

KCS supports the Board's effort to require service assurance plans, which would provide a blueprint for the implementation and progress of proposed mergers. KCS also agrees with the Board that contingency plans should be a necessary component of merger applications. Both requirements would alleviate problems associated with past mergers, such as misinformation and confusion in trying to predict how merging parties will implement a merger. The more information required and produced during merger proceedings, the easier it will be on all parties during the implementation of a merger.

KCS also believes, however, that the requirement of such detailed service assurance plans assumes that railroads can accurately predict future events and plan for them. In that sense, the proposed rule seeks specific information from the railroads that ultimately may not be available. It is difficult to envision how any party will predict future events with the kind of accuracy implied in the proposed service plans. In addition, the contingency plans called for by the STB are unrealistic as to the information to be collected from the merger applicants. Like the proposed service assurance plans, the proposed contingency plans require too much specific

information that the railroads may not be able to predict. Although contingency plans should be a requirement of merger applications, the information required should be more realistic.

Finally, KCS supports the STB's proposed establishment of problem resolution teams and procedures to address problems that may arise in the process of merger implementation. In addition, KCS thinks that mandatory Service Councils will be in the best interests of the industry. The provision of a forum for the ongoing discussion of the proper implementation procedures to be used in a recently-approved merger will benefit merging parties, other rail carriers, and shippers.

Section 1180.1(i) - Cumulative Impacts and Crossover Effects

KCS supports AAR's comments concerning the unmanageability of the Board's proposal on cumulative and crossover effects. While merging Class I railroads may be able to anticipate some sort of competitive response to their merger, the exact structure of that responsive merger is subject to an almost infinite variety of possibilities. To base the Board's approval and conditioning of a rail merger on a prognostication of future events is to rely upon fortuity and happenstance, rather than analytical reasoning. For example, would BN/SF or UP/SP have been expected to project in their mergers the structure of NS and CSX's division of Conrail's assets, including the creation of Shared Assets Areas in some of the most important business areas in that territory? Could anyone reasonably have been expected to predict the ultimate scope of BNSF trackage rights over the merged UP/SP, as opposed to the possible divestiture of lines suggested by some parties?

Anticipating and planning responses to the almost infinite variety of possible competitive responses to a merger would place an unmanageable burden on rail merger applicants. The

Board's proposal that merger applicants list conditions that could be imposed on their mergers in the event of a future merger is an exercise in conjecture, as the predictability of the shape of future mergers is uncertain. In any event, current merger applicants are unlikely to suggest additional conditions that could be used against them currently or as a baseline against which future applicants would begin to plan.

It would be far more fruitful to require downstream applicants to propose conditions to enhance and preserve the benefits generated by upstream mergers, particularly those mergers in which they have been previously involved. With the exception of KCS and Canadian Pacific Railway, all of the existing Class I railroads have been involved in large-scale rail mergers in the last five years. These mergers were in turn the product of mergers involving many regional and smaller railroads. In the approval of all of these mergers, the Board and its predecessor have focused on the imposition of conditions to preserve the public interest. KCS' suggestion that the Board focus on "upstream effects" is really nothing more than a desire to see the Board recognize the successes and failures wrought by these many mergers, and to assure that conditions imposed on any future mergers further the public interest through the preservation and enhancement of competition that resulted from the imposition of a condition in a previous merger.⁹

The Board's consideration of cumulative and cross-over effects (i.e., "upstream," "current," and "downstream") should include modification of conditions imposed in previous mergers if: (A) necessary to remedy cross-over and cumulative anti-competitive effects and (B)

⁹ "Upstream" effects traditionally have been included in the formulation of "cross-over and cumulative effects." The question posed by the traditional consideration of cross-over and cumulative effects has been "How do the competitive impacts of previously approved mergers implicate the competitive impacts of the merger under consideration?" Thus, the "cumulative" effects which were considered started with "upstream" effects and ended at "current merger" effects. The Board's proposed rules would simply extend this consideration of the cumulative impact of "upstream effects" to include "downstream effects."

if the Board has jurisdiction over the party upon whom the modified condition is imposed, either by virtue of that party being a party to the merger under consideration or being subject to the Board's oversight jurisdiction. In neither instance would the Board be retroactively imposing a condition. In the case of the modified condition being imposed on a party to both the previous and currently considered merger, the modified condition is a new condition, imposed to remedy the "cross-over and cumulative effects." Of course, by the very terms of its order retaining oversight jurisdiction, the Board would retain the right to impose modified conditions – once again in response to the "cross-over and cumulative" effects.

In his comment on the *NPR*, Vice Chairman Burkes succinctly stated why the Board needs to be concerned about upstream effects (*NPR*, at 39-41). Mergers are not drawn of whole cloth, but instead are formulated in part on the conditions imposed in prior mergers. These upstream conditions will undoubtedly be impacted by future mergers, as service plans change, shippers gain new single-line service, and privately-negotiated agreements are drawn to preserve existing competitive options. As the Vice Chairman well stated, the impact of merger changes on upstream effects needs to be reviewed, so that the "whole picture" is addressed by the Board. To do otherwise is to risk exclusion from consideration of viable competitive improvements.

In order to provide the Board with the "whole picture," KCS proposes that the last sentence of subsection (i) be revised to read "Applicants will be expected to list all conditions imposed in any prior mergers they have undertaken, and to discuss whether those conditions need to be modified to preserve and enhance competition." The need to tie the enhancement of competition to conditions imposed in prior mergers is apparent. Without such a tie, parties will have no direction or focus as to the areas in which they should seek to "preserve and enhance" competition. By requiring merging parties to direct their preservation and enhancement efforts

towards prior merger (i.e., “upstream”) conditions, the Board will appropriately limit the extent to competitive enhancements to areas where merger approval has not maximized the public interest.

1180.1(j) - Inclusion of Other Carriers

No comment.

1180.1(k) Transnational Issues

No comment.

1180.1(l) - National Defense

No comment.

1180.1(m) - Public Participation

KCS supports the Board’s revision of former rule 1180.1(h). Recognition should be given to the important perspective provided by rail labor and third parties in merger proceedings.

1180.3(a) - Definitions; Applicant

KCS supports the Board’s modification of the definition of “Applicant.” The definition contained in the current regulations is overly broad, resulting in routinely granted requests for waiver.

1180.3(b) - Definition; Applicant Carrier

KCS supports the revision of this regulation as proposed by the Board. The refocused regulation casts a sufficiently broad net to include only those carriers whose operations should be of interest to the Board.

1180.4(a)(1) - General

KCS supports the administrative adjustment proposed for this regulation.

1180.4(a)(4) - Service Lists

KCS supports the deletion of the scheduled release of service lists, as the Board's recent practice with respect to service lists has proven adequate.

1180.4(b)(4) - Prefiling Notification

KCS supports all of the Board's initiatives in proposing this new, multi-section regulation. The Board's existing practice of designing an appropriate procedural schedule tailored to the specifics of the proposed transaction (and allowing the applicants to open and close the debate on what constitutes an "appropriate" schedule) should be retained, and is adequately codified in the proposed regulation. Similarly, while it is possible to distill from recent merger transactions a "standard" protective order, KCS believes that the proposed rule provides the proper flexibility to allow parties to address specific concerns in their draft protective order. Reciprocal waybill availability is also supported by KCS, although KCS also assumes that the Board will be amenable to consider waiver petitions from non-applicant carriers

in appropriate circumstances. Finally, KCS supports the Board's proposed voting trust regulation.

1180.4(c)(6) - Application Format

KCS supports the Board's adoption of a regulation codifying the past practice of allowing applicants to provide consolidated information and data relating to their controlled affiliates.

1180.4(d) - Responsive Application

KCS supports the Board's revisions to its regulation dealing with responsive applications. The deadlines for such applications can best be set on a case-by-case basis.

1180.4(e) - Evidentiary Proceeding

KCS supports the Board's efforts to modify the existing regulations to accurately reflect the time parameters currently specified in the relevant statute.

1180.4(f) - Waiver or Clarification

KCS supports the Board's clarification of this regulation to comport with changes made elsewhere to the regulations.

1180.6(b)(1), (2), (3), (4), (6), (8) and (9) - Various Corporate Forms

KCS supports the Board's additions and modifications to this existing regulations, which will now more closely reflect with both existing corporate law and the realities of Class I corporate structure.

1180.6(b)(10) - Conditions To Mitigate And Offset Merger Harms

KCS generally supports this proposed rule, which implements the policy statement found at Section 1180.1(d). However, as drafted, the rule is unnecessarily vague. The focus of the Board's merger review should be on the preservation of competitive rail service options and enhancement of rail-to-rail competition needed to preserve those options. Mergers should not reduce competition among railroads, and the conditions imposed in mergers should likewise be designed to preserve and enhance competition among railroads.¹⁰ A contrary position leads to curious results, such as merger applicants proposing conditions designed to improve the merged entity's ability to compete against trucks even though the shipper is disadvantaged through the loss of rail competition. The regulation should be modified so as to make clear that the form of competition of paramount interest to the Board in a rail merger proceeding is rail-to-rail competition.

In addition to the preservation of "the use of major gateways, the potential for build-outs and build-ins, and the opportunity to enter into contracts for one segment of a movement as a means of gaining the right separately to pursue rate relief for the remainder of the movement," KCS believes that the Board should modify the proposed regulation by adding a fourth preservation: the preservation of benefits conferred on shippers in prior rail mergers. Merger approval is dependent in part upon an assessment of the benefits to be provided to shippers,

¹⁰ The Board's reservation of the freedom to impose conditions which "enhance" competition is absolutely necessary to the Board's obligation to "preserve" competition. That is, the Board should not be restrained from adding rail carriers to a market or corridor if new carriers are necessary to preserve the competition previously provided by merger applicants. In point of fact, while a "headcount" would deem such additions the enhancement of competition, they are nothing more than the preservation of competition. However, having endorsed this definition of enhancing competition, KCS also believes that any such enhancement must be related to the anti-competitive effects of a merger. The Board should make absolutely clear that it will not impose

which is an element of the ultimate test of the public interest. The Board's merger regulation will be improved substantially if parties are held responsible for preserving the benefits they claim to have imparted in prior proceedings. By that same token, parties should not be allowed to disavow prior merger benefits based on the exigencies of their next merger.

1180.6(b)(11) - Calculating Public Benefits

KCS supports the Board's adoption of this new regulation, which should compel merger applicants to more closely consider the impact which the proposed transaction will have on shippers, other carriers, and select regions and markets of the country. In addition, KCS believes that the quantification of these considerations will provide a more objective basis for all interests to debate the merits of the proposed combination.

Section 1180.6(b)(12) - Downstream Merger Applications

As stated with respect to the Board's policy statement on cumulative and crossover effects, KCS supports AAR's position that the Board's proposed changes to this rule would require unmanageable speculation about the structure of possible future mergers and unproductive conjecture about what steps might be needed to address circumstances arising from a variety of possible future merger scenarios. Applicants' time would be more productively spent addressing the cumulative effects of the proposed merger on benefits derived from previous mergers, and suggesting ways to ameliorate those effects, as the Board has allowed in the past. In that sense, KCS believes the Board's analysis would be better placed by focusing on so-called

competition enhancing conditions unless they are needed to address a merger's competitive harms.

upstream effects. As reflected at greater length in the discussion of the Board's proposed modifications to Section 1180.1(i), the public interest would be best served through the preservation and enhancement of competition recognized in past mergers, whether that competition was achieved through voluntary agreements or conditions imposed by the Board or its predecessor. In particular, a focus on assuring that past merger conditions were imposed, and remain, in the public interest would allow the Board to preserve and enhance competition in a limited manner, and in a way directly tied to the merger applicants.

1180.6(b)(13) - Purpose of the Proposed Transaction

KCS supports the Board's proposed revision to former regulation 1180.6(a)(1)(iii). The purposes listed in the revised regulation, while simply reciting examples of possible merger purposes, are more illustrative of the merger purposes commonly pursued by modern Class I railroads than are reflected in the current rule.

1180.7 - Market Analyses

KCS supports the Board in the changes it has proposed to this section, particularly with respect to the use of market share data. In many past mergers, the debate over a merger's market impacts was handicapped by the absence of a common methodology. One party's assessment of competitive effects was rebutted by those of another party using different assumptions and techniques, with no clear-cut measurement standard of universal application. The changes proposed for this section will not only help to achieve a more complete record, but will also go a long way toward eliminating the "apples to oranges" criticism often leveled in the past. In addition, for many years KCS has espoused the belief that the Board cannot adequately preserve

and protect competition merely by counting the number of competitors present in a market or corridor. The level of the competition provided, as approximated by the relative market share of the operating rail competitors, should be assessed before any conclusion can be drawn regarding the sufficiency of competition remaining after a merger. Indeed, KCS believes that if market share data were the touchstone of the Board's competitive analysis in prior mergers, a significantly greater level of rail competition would exist in many markets today.

The Board's proposed new emphasis on measuring the effect of competition on the reduction in the number of competitors from three to two (*NPR* at 34) represents definite progress toward a more realistic assessment of competitive impacts. The national rail transportation market is too complex in its interline relationships and varied market coverage to allow for the simple proposition that two competing railroads are sufficient in all instances.¹¹

While KCS supports all of the changes proposed by the Board for this section, it also believes that several additional, modest changes could be made which would further enhance the utility of this rule. First, the Board should clarify that the requirement of Section 1180.7(b)(6), compelling "an explicit delineation of the projected impacts of the transaction on the ability of various network links (including Class II and Class III rail carriers and ports) to participate in the competitive process and to sustain essential services," should also include a disclosure of and justification for all existing paper and steel barriers currently impacting operation of those links.

¹¹ The Board's previous analysis relied upon counting the numbers of rail competitors rather than comparing the relative strength of those competitors in the various, relevant transportation markets. Greater realism and improved accuracy will be achieved when the Board includes in its competitive analysis the pre- and post-merger market shares of those competitors, as is proposed in this revised Section. In addition, the Board should consider whether future mergers need to be conditioned to restore and enhance competition lost in previous mergers. In prior mergers, the Board counted the number of competitors and then acted to preserve competition by ensuring there were at least two carriers without regard to the competitive role each competitor played in

The Board has already taken the logical step of indicating that the impacts on smaller carriers and ports need to be reviewed in a major merger. It is now time to flesh out that statement by putting all interested parties on the same informational footing. The impact of a merger on smaller carriers cannot be accurately assessed if all of the relevant restrictions on that carrier's operations are not fully disclosed. In addition, disclosure of all paper and steel barriers will assist the Board in determining what competition-enhancing conditions it might need to prescribe in order to ensure that the transaction furthers the public interest.

Second, while KCS supports the Board's new regulation requiring the disclosure of all "2-to-1" and "3-to-2" points (Section 1180.7(b)(2)), that disclosure is not as effective as it could be because it does not take into account shippers who had access to two or more carriers (one or more via reciprocal switch) but were reduced to one carrier access through the cancellation of reciprocal rights just prior to the announcement of the merger. In other words, certain shippers would have qualified for the Board's traditional relief from their reduction in competition but for the fact that their access to additional carriers was restricted on the eve of a merger. KCS is not suggesting that the cancellation of reciprocal switching rights and other forms of access do not on occasion have legitimate business purposes, but the possibility for canceling such rights in order to avoid access by third parties is undeniably present. KCS believes that requiring the disclosure of such cancellations that occurred within 24 months prior to the announcement of a rail merger will discourage the incentive to use this competition-reducing technique.

Finally, the expanded disclosure requirements manifested in the proposed regulation also lend themselves to an analysis of whether conditions imposed in prior mergers continue to

the marketplace and whether or not those two carriers actually preserved the same level of competition that had previously existed in that market, not simply the same number of carriers.

operate in the public interest. In order to provide any meaningful analyses of the subject, however, the proposed regulation must be modified to require merger applicants to disclose and discuss the competitive impact of all conditions imposed on them, or any of their predecessor railroads, in prior mergers. With this information, the Board can determine whether conditions need to be imposed on any merger authority to assure that prior conditions operate in accord with the Board's revised view of the public interest. Such a revision to this regulation would be entirely consistent with the Board's most recent pronouncements regarding the importance of enhancing competition in merger proceedings.

1180.8 - Operational Data

KCS supports the Board's efforts under this proposed rule to require applicants to submit operating plans prior to approval of a merger in order to better understand the effects of the approved transaction and to better anticipate the problems that may arise in the implementation of the new system.

1180.10 - Service Assurance Plan

In line with virtually every other party to address the issue in this proceeding, KCS supports the Board's efforts to adopt a service assurance plan as a key component of a merger application. In many recent mergers, KCS found it difficult to assess the applicants' vision of the operation of their final, combined system because of the lack of any timeline showing how the applicants expected to reach that final system from the existing separate systems. Properly framed, service assurance plans should provide the necessary blueprints for integration. Perhaps even more importantly, the service assurance plans should afford shippers and connecting

carriers (including shortlines) an enhanced opportunity to assess the immediate impacts of the proposed merger on their service and operations.

In conjunction with the comments of AAR, however, KCS also has concerns that the service assurance plan will be treated by certain parties as an immutable mandate which must be carried out even in the face of changed circumstances. While the level of detail proposed for this new regulation will assure that parties have adequately thought through their proposed combination, it is likely that even the most carefully crafted service assurance plan will not accurately anticipate many of the factors which impact daily rail service. Indeed, many of these factors are largely outside of a railroad's control, such as changing market forces, the timing of labor implementing agreements, and other similar circumstances. It would be nonsensical to require a railroad to follow to the letter a service assurance plan which had been drafted several years earlier and which was no longer in the best interests of the merged railroads and the shipping public.

On the other hand, merger applicants should not be allowed to entirely disregard the plans they put forth for implementing their merger during the merger approval process. Although the Board's existing oversight procedures provide a limited level of cross-check on the applicants' progress in implementing their merger, the oversight process has been hamstrung by lack of an effective implementation plan by which to measure the progress of systems integration.

Therefore, to balance these concerns, KCS believes that the Board should clarify the role that the service assurance plan will play in ongoing merger oversight. KCS respectfully submits that such a clarification should make clear that the service assurance plan is designed as background to a specified level of rail service and operations, and that while railroads will not be held to comply with all of the services contemplated in the plan, they will be required to provide

the overall level of service envisioned for the integration period. By framing the clarification in this manner, the Board should quell the concerns of potential railroad applicants that they will be held to outmoded plans while allowing other parties to rely upon the general service levels reflected in those plans.

1180.11 - Additional Information Needs For Transnational Mergers

No comment.

Conclusion

In summary, KCS believes that the Board has made significant strides toward improving the merger review and conditioning process for all concerned parties. An update of the rules was badly needed, and the revisions suggested by the Board propose significant improvements. With the minor adjustments suggested by KCS herein, the Board's merger regulations will establish an appropriate framework for rail merger review for many years to come.

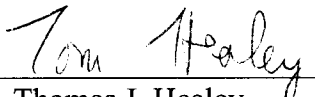
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CERTIFICATE OF SERVICE

This is to certify that on this 17th day of November, 2000, I caused the foregoing
“Comments of the Kansas City Southern Railway Company on the Notice of Proposed
Rulemaking” in the Ex Parte No. 582 (Sub-No. 1) proceeding to be served upon counsel for all
known parties of record by first class mail, postage prepaid, or by more expeditious means.



Thomas J. Healey