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July 19, 2002

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



Re: Finance Docket No. 34177
*Iowa, Chicago & Eastern Railroad Corporation --
Acquisition And Operation Exemption -- Lines Of I&M Rail Link, LLC
Reply Of The Kansas City Southern Railway Company*

Dear Secretary Williams:

Enclosed for filing are the original and eleven copies of the "Reply Of The Kansas City Southern Railway Company" to the July 16, 2002 letter filed by Iowa, Chicago & Eastern Railroad Company in the above referenced docket. Please time and date stamp the extra copy of the Reply and return it with our messenger.

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

Very truly yours,

William A. Mullins

Enclosure

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Office of Proceedings

JUL 22 2002

Part of
Public Record

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

FINANCE DOCKET NO. 34177



**IOWA, CHICAGO & EASTERN RAILROAD CORPORATION
-- ACQUISITION AND OPERATION EXEMPTION --
LINES OF I&M RAIL LINK, INC. LLC**

REPLY OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY

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July 19, 2002

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

FINANCE DOCKET NO. 34177



**IOWA, CHICAGO & EASTERN RAILROAD CORPORATION
-- ACQUISITION AND OPERATION EXEMPTION --
LINES OF I&M RAIL LINK, INC. LLC**

REPLY OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY

The Kansas City Southern Railway Company ("KCS"), by its counsel, hereby provides the Surface Transportation Board ("STB" or the "Board") with its "Reply" to the July 16, 2002 letter filed by Iowa, Chicago & Eastern Railroad Corporation ("IC&E") in Finance Docket No. 34177, *Iowa, Chicago & Eastern Railroad Corporation -- Acquisition And Operation Exemption - Lines Of I&M Rail Link*. The July 16 IC&E letter claims that "shippers and connecting carriers have withdrawn prior questions" and "now strongly and unanimously support the transaction." IC&E's filing suggests that all outstanding questions have been adequately addressed as they relate to IC&E's acquisition of the assets of I&M Rail Link, LLC ("IMRL"). It is true that some very significant issues appear to have been resolved, *i.e.* access to Chicago and concerns raised by IMRL's largest shipper, and IC&E should be commended for working to resolve these issues.

As for the matters raised by KCS and addressed in IC&E's July 16 letter to the Board, KCS is pleased to report that just yesterday, IMRL executed an agreement governing the movement of grain between KCS and IMRL/IC&E that appears to ensure that the competitive, independent routing for grain shippers in the Midwest that is currently provided by the KCS/IMRL relationship will not be eliminated, reduced, or altered as a result of IC&E's

acquisition of IMRL's assets.¹ Despite this progress with respect to Chicago and Midwest grain shippers, there are still some outstanding public interest concerns that IC&E has not fully addressed. These remaining issues will require careful attention in the anticipated "control" portion of this proceeding. KCS has taken this opportunity to briefly outline some of those issues in these Comments.

A. The KCS/IMRL Relationship

As KCS noted in its "Comments" filed June 19 and as verified by David C. Bastress, Vice President Marketing, Agriculture and Minerals Business Unit for KCS, KCS and IMRL have a Marketing Agreement (the "1997 Agreement"). Through the 1997 Agreement, KCS has worked very closely with IMRL in order to provide shippers with a competitive alternative to the large Class I systems, such as Burlington Northern Santa Fe and Union Pacific. As a result, IMRL is now KCS's largest non-Class I interchange partner, and the geographic reach of the two carriers provides shippers with an important, independent routing option. The 1997 Agreement effectively established a viable alternative route for shippers from Mexico to Chicago.²

IMRL's recent execution of the previously-referenced grain agreement has significantly furthered the partnership created by KCS and IMRL in the 1997 Agreement. However, the 1997 Agreement contains provisions that would allow either party to terminate the relationship on short notice. IC&E has agreed to meet with KCS early next week to discuss an extension of the term of, and elimination of the early cancellation provision contained in, the 1997 Agreement.

¹ IC&E has not yet given KCS assurances in writing that it will assume this new agreement upon taking over ownership of IMRL's assets. However, as with other agreements and consistent with statements that IC&E has made to this Board, KCS assumes that this agreement will be assigned and assumed by IC&E as part of the Asset Purchase Agreement. Failure to do so will result in a loss of the competitive options currently utilized by Midwest grain shippers.

² IC&E has represented to this Board that it will assume IMRL's obligations under the 1997 Marketing Agreement and KCS fully expects that IC&E will abide by this representation.

KCS strongly believes that a longer, non-cancelable term for the 1997 Agreement would be in the best interests of all concerned shippers, and is the only method to protect this vital independent route.

The shipping public is best served through a strong, independent carrier, such as IMRL, and any proposal to change control of IMRL, or transfer its assets, should meet the public interest test. As IC&E stated in its July 16 letter, "[t]he Board's task here is to protect the public interest." Preserving the competitive options provided by the KCS/IMRL relationship should be of utmost importance to this Board, and should be a centerpiece of the Board's analysis of Dakota, Minnesota, & Eastern Railroad Corporation's ("DM&E") impending control filing. In its filing of July 16, IC&E stated that it is "in the interest of both railroads to work together." In that spirit of cooperation, KCS looks forward to playing a role in IC&E's efforts to keep IMRL's routes financially strong and independent.

B. The Relationship With Labor

As the Board is aware, six labor organizations have requested the Board to stay this transaction in order to allow adequate time to conduct discovery, develop the record, and resolve any outstanding issues. While IC&E's July 16 filing acknowledges labor's opposition, it does not indicate that labor's concerns have been fully addressed. The filing made by labor earlier this week is a clear indication that not all issues have been resolved on the labor front.

KCS has no first-hand knowledge of IC&E's discussions with labor. However, a prompt resolution of those issues is important to all shippers that depend upon an efficient connection between KCS and IMRL/IC&E. If service is truly to remain seamless after the transaction, labor's concerns must be addressed.

C. The Financial Ability Of IC&E To Operate IMRL's Assets

Much has been said in this docket about IMRL's financial condition, but KCS believes that is not the appropriate inquiry. The issue is not the current state of IMRL's financial affairs, but rather IC&E's ability to consummate the transaction and run a Class II railroad on track that, over the last decade, has provided a Class I carrier (Soo Line) and a very experienced Class II operator (Montana Rail Link) with marginal financial results, at best. To date, IC&E has not established that it has secured any lock-tight financing. In fact, in the last few weeks, IC&E's President, Robert Brownell, stated that "[w]ork continues on finalizing the financing arrangements." June 22 Reply of IC&E, Exhibit 2, V.S. Brownell at 32 (emphasis supplied).

The absence of a solid commitment for financing properly raises concerns among shippers and connecting carriers. As the Iowa Department of Transportation points out, there are questions about the financial arrangements that the public has been unable to review. *June 12 Comments of Iowa Department of Transportation*, at 2. This issue was also raised by the Cooperating Labor Organizations in their June 13 Petition for Stay at page 7 and in KCS' June 19 Comments.

Despite IC&E's recent comments to the Board, KCS has seen no evidence that the concerns raised about IC&E's financing have been adequately resolved. The issue of financing will undoubtedly be a prominent one in the impending control proceeding, given DM&E's aspirations to build into the Powder River Basin.

D. Chicago Access

Given the importance of the Chicago gateway, its use for IMRL/KCS shipments to Mexico, and UP's use of the IMRL Kansas City to Chicago line, the ability of IC&E to reach Chicago is of crucial importance. As of this date, there does not appear to be an agreement

between IC&E and Metra so that IC&E may utilize IMRL's existing routing into Chicago. IC&E claims to have resolved this issue through their negotiation and acquisition of haulage rights over the Chicago, Central & Pacific Railroad and the Iowa Interstate Railroad. However, if these alternative haulage rights are used, what is the future of IC&E's existing line that connects with Metra's tracks and on which IMRL currently operates? The loss of overhead traffic may make IMRL's existing route to Chicago financially untenable, or its continued operation may provide a financial drag on IC&E's operations that it simply cannot overcome. Moreover, no study has yet come to light establishing that the haulage service negotiated by IC&E will allow IC&E to remain competitive to and from the Chicago market. Likewise, Chicago to Kansas City to Mexico shippers need assurances that their rates will not rise as a result of the haulage agreements and KCS needs assurances that its divisions will not change. These issues bear careful scrutiny in the coming control case.

E. The Voting Trust

Because of the focus on access to Chicago and the future financial viability of IC&E, the fact that IC&E will be placed in a voting trust pending common control authority (a period that could last as long as a year) has largely gone unnoticed. Certainly, voting trusts have become a common device to assure that control is not prematurely exercised. However, KCS is unaware of any examination of the voting trust proposed to be used by IC&E. At a minimum, the terms of the trust, and the identity of the trustee, may have a substantial impact on IC&E's operations. Furthermore, the trust must insulate IC&E from unlawful control by DM&E. Consistent with 49 CFR Part 1013, KCS presumes that the trust agreement will be filed with the control application and the Board and public given an opportunity to review its terms and conditions.

CONCLUSION

In summary, KCS is pleased that IC&E has recognized the obligations that it has to be mindful of the public interest in this transaction and has resolved many of those concerns. However, the Board should not believe that all of the legitimate issues raised by certain parties in this docket have been properly addressed. The Board should make it clear that whatever issues remain can most properly be resolved once the control case has been filed, and the public is given the opportunity to review a more complete record and determine how the interests of all stakeholders (carriers, shippers and labor) can be addressed.

Respectfully submitted,



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July 19, 2002

CERTIFICATE OF SERVICE

This is to certify that on this 19th day of July, 2002, I caused the foregoing "Reply Of The Kansas City Southern Railway Company" in Finance Docket No. 34177, *Iowa, Chicago & Eastern Railroad Corporation -- Acquisition And Operation Exemption -- Lines Of I&M Rail Link* to be served upon counsel for all known parties of record by first class mail, postage prepaid, or by more expeditious means.


William A. Mullins