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BAKER & MILLER PLLC
ATTORNEYS AND COUNSELLORS

SUITE 1000
915 15TH STREET, N.W.
WASHINGTON, D.C. 20005-2318
TELEPHONE: (202) 637-9499
FACSIMILE: (202) 637-9394



July 21, 2003

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

Re: *Kansas City Southern - Control - The Kansas City Southern Railway
Company, Gateway Eastern Railway Company, And The Texas Mexican
Railway Company; Finance Docket No. 34342*

Dear Secretary Williams:

Enclosed please find an original and twenty-six (26) copies of the Reply Of Kansas City Southern, The Kansas City Southern Railway Company, Gateway Eastern Railway Company, And The Texas Mexican Railway Company (KCS-16/TM-16) to the Petition Of Canadian National Railway Company To Reopen Decision No. 2 And To Reject Application. A copy is also provided on the enclosed diskette.

Please date-stamp the twenty-sixth copy of the filing and return it to the courier for our files.

Sincerely,


William A. Muhins

Enclosure

cc: Parties of Record

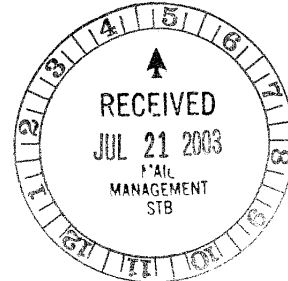
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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Finance Docket No. 34342

KANSAS CITY SOUTHERN

- CONTROL -



**THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY and
THE TEXAS MEXICAN RAILWAY COMPANY**

**REPLY OF KANSAS CITY SOUTHERN,
THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY AND
THE TEXAS MEXICAN RAILWAY COMPANY TO PETITION
OF CANADIAN NATIONAL RAILWAY COMPANY
TO REOPEN DECISION NO. 2 AND TO REJECT APPLICATION**

**Richard H. Streeter
BARNES & THORNBURG
750 Seventeenth Street, NW
Suite 900
Washington, DC 20006
Tel: (202) 289-1313
Fax: (202) 289-1330**

**Attorney for The Texas Mexican Railway
Company and Mexrail, Inc.**

**William A. Mullins
David C. Reeves
Baker and Miller, PLLC
915 15th Street, N.W.
Suite 1000
Washington, DC 20005
Tel: (202) 637-9499
Fax: (202) 637-9394**

**W. James Wochner
Thomas J. Healey
KANSAS CITY SOUTHERN
427 West 12th Street
Kansas City, MO 64105
Tel: (816) 983-1303
Fax: (816) 983-1227**

**Attorneys for Kansas City Southern,
The Kansas City Southern Railway
Company, and Gateway Eastern
Railway Company**

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PREFACE AND SUMMARY OF ARGUMENT¹

Kansas City Southern ("Applicant" or "KCS"), The Kansas City Southern Railway Company ("KCSR"), Gateway Eastern Railway Company ("Gateway Eastern"), and The Texas Mexican Railway Company ("Tex Mex") hereby respond to the Petition of Canadian National Railway Company ("CN") filed July 14, 2003. As a basis for its request, CN does not claim material error or new evidence, but instead claims that circumstances have "substantially changed" since issuance of Decision No. 2 so as to warrant reopening of Decision No. 2. CN, joined by Union Pacific Railroad Company ("UP"), then takes the extraordinary step of asking that the Application be rejected, notwithstanding the facts that neither CN nor UP opposed

¹ 49 C.F.R. §1115.4 requires parties who file a petition to reopen over 10 pages in length to comply with 49 C.F.R. §1115.3(d), which requires parties to include a separate preface and summary of argument. Neither CN nor UP complied with this requirement.

acceptance of the Application in their filings prior to Decision No. 2, that the Board specifically found in Decision No. 2 that the Application prior to the filing of the supplemental evidence satisfied the Board's requirements for a minor transaction, and that the parties have been proceeding under the procedural schedule for over 40 days since issuance of Decision No. 2.

CN, joined by UP, claims that the type and substance of the supplemental information contained in the Supplement was so inadequate to describe KCS's plans to acquire control of TFM, that there are "substantially changed circumstances" warranting rejection of the Application describing KCS's plans to acquire common control of KCSR, Gateway Eastern, and Tex Mex. CN's request should be denied. What CN claims as changed circumstances is the alleged failure by KCS to supplement the Application in the way that CN believes it should have been supplemented. The answer to CN's and UP's concerns is not to reopen Decision No. 2 and reject the Application. Instead, the answer is for CN and UP to make their case when they file comments to the Environmental Appendix, the Safety Integration Plan, or on the merits of the Application itself. CN and UP are free to raise any and all of their concerns in their comments. But CN has utterly failed in its attempt to establish that circumstances have changed since the Board found that the Application was sufficient. Indeed, filing additional evidence about a transaction not even subject to the Board's jurisdiction cannot, by its very nature, make the Application describing the KCS/Tex Mex transaction insufficient. The Board properly accepted the Application on June 9, 2009. It should reject CN's and UP's request and proceed in accordance with the schedule set forth in Decision No. 2.

ARGUMENT

I. CN BEARS A HEAVY LEGAL BURDEN TO JUSTIFY REOPENING

CN and UP are, in effect, seeking an untimely appeal from the Board's Decision No. 2. CN and UP filed comments on the proposed Application and proposed procedural schedule, but at no time in those comments did either CN or UP argue that the Application should be rejected because it was deficient. Having failed to previously make these arguments, CN and UP must satisfy a heavy burden to prevail.

A party seeking to reopen must establish that the Board's prior decision should be nullified because of either material error, new evidence or substantially changed circumstances. 49 C.F.R. Section 1115.4 (2002). In this instance, CN has chosen to rely on alleging that circumstances have substantially changed since Decision No. 2 was issued. To prevail under this standard CN must show that facts relating to the sufficiency of the Application are different now than they were on June 9, and that those facts are so important that reopening and reversal of Decision No. 2 is required. *See, e.g., Santa Fe Southern Pacific Corporation - Control - Southern Pacific Transportation Company*, Finance Docket No. 30400, 1987 WL 99095 (decided July 30, 1987) at *6 ("It is essential to reopening on the basis of new evidence and changed circumstances that any such information, taken as presented, would so materially alter or change the case that one might now reasonably reach conclusions different from the original conclusion."); *see also S.R. Investors, Ltd., Doing Business As Sierra Railroad Company - Abandonment - In Tuolumne County, CA*, Docket No. AB-239X, 1988 Westlaw 225711 at *2 (decided Jan. 20, 1988)(a party who seeks reopening based on claimed new evidence must show that the evidence is indeed new and was previously unavailable). CN has not met this burden.

What CN claims as substantially changed circumstances is not that the facts relevant to the KCS/Tex Mex transaction were inadequately presented, but that KCS did not present enough evidence with respect to the KCS/TFM transaction. Of course the circumstances relating to the content of the Application have not changed. In fact, when CN had the opportunity to comment on the scope of the evidence presented in the Application, it chose to submit only three paragraphs addressing the proposed procedural schedule and did not challenge the sufficiency of the Application at that time. Since the issuance of Decision No. 2, the only changed circumstance relevant to CN's Petition has been that additional information has been submitted in support of the Application. CN's argument that adding information to an otherwise sufficient application constitutes "substantially changed circumstances" making the application insufficient is simply absurd.

**II. CN'S PETITION, SUPPORTED BY UP,
DOES NOT JUSTIFY REOPENING DECISION NO. 2**

The apparent premise of CN's argument is that the Board's decision to either accept or reject the Application depended upon, or was somehow contingent upon, KCS providing supplemental information with respect to the KCS/TFM transaction. This premise is incorrect. The Board did not say that it was "conditionally" accepting the Application subject to its supplementation, nor did the Board suspend the procedural schedule pending additional information, both of which would have to be true for CN's argument to prevail. Instead, the Board accepted the KCS/TM Application for consideration in compliance with 49 U.S.C. § 11325(a), because it was in substantial compliance with the Board's regulations. Once the Board found that the Application was in substantial compliance with its regulations and accepted it, it is illogical to say that additional information supporting the Application somehow constitutes changed circumstances such that the Application is now deficient.

The gist of CN's Petition and UP's support for that Petition is a disagreement with KCS's contentions concerning the effect that KCS's control of TFM will have on U.S. operations. The answer to these concerns is not to reopen Decision No. 2 and reject the Application or even to ask for further information. Instead, the answer is for CN and UP to make their case when they file comments to the Environmental Appendix, the Safety Integration Plan, or on the merits of the Application itself. CN and UP are free to raise any and all of their concerns in their comments.

If CN or UP believe that KCS has underestimated the amount of diversions that may occur if both Tex Mex and TFM are brought under common control and the impacts of those diversions in the U.S., then they have all of the tools and resources available to them to perform their own study to present their case. If CN believes that there was an inadequate discussion of "source competition" as CN defines it, CN should present its own study and analysis of why Dr. Grimm's analysis was inadequate. If CN believes that the environmental appendix or the SIP is inadequate, CN is free to comment and establish why. None of these alleged deficiencies constitute "substantially changed circumstances" but are simply arguments over the weight and scope of the evidence presented.

A. The Competitive Analysis Contained In The Application Was Not Deficient

The Board stated clearly in Decision No. 2 that it was accepting the Application because "it is in substantial compliance with the applicable regulations governing minor transactions." Decision No. 2 at 6. The Board found no defects or problems with the competitive analysis of the KCS/TM transaction in isolation. Its only request for additional information was to address the implications of the KCS/TFM transaction on the KCS/TM transaction. The KCS Supplement was completely responsive to that request.

CN alleged that the “defect” with the competitive analysis contained in the Application (as opposed to the Supplement) indeed the “most important” alleged defect (CN Petition at 8), was an alleged failure to adequately consider the loss of source competition caused by the KCS/Tex Mex transaction in isolation.

Because Applicants only considered source competition issues where the originating railroads deliver a commodity to a commonly served destination, they excluded any analysis of potential source competition between KCS and TM that might exist if there were origins for a particular commodity on both KCS and Tex Mex and receivers anywhere in the United States who could choose between these origins. Applicants’ failure initially to apply the correct source competition test, which looked at the effects of the KCS/Tex Mex transaction taken in isolation, was replicated in the Supplement.

CN Petition at 9-10 (emphasis supplied). While CN may believe this to be a defect in KCS’s analysis, the Board examined the KCS/Tex Mex competitive analysis and clearly did not find this to be a “failure.” The Board was reasonable to so conclude.

The Board and KCS are very familiar with the concept of source and geographic competition, as is Dr. Grimm. The issue is simply one of focusing on potential instances of reduction of independent competitive alternatives when performing a competitive analysis of a rail consolidation. CN quotes the ICC’s definition of geographic competition in its filing: “Geographic competition is a restraint on rail pricing stemming from a shipper’s or receiver’s ability to get the product to which the rate applies from another source, or ship it to another destination.” CN Petition at 9. However, the shipper’s ability to draw from an alternative source provides a restraint on rail pricing only where the alternative source also provides a different and independent rail routing. If the alternative rail routing is not independent (*i.e.* the same carrier appears in both routes) then the alternative source does not provide a competitive restraint on rail pricing because one carrier has a “bottleneck” in every rail routing and thus has the ability to extract any excess economic rent that would have otherwise been provided by the alternative

source. That is why Dr. Grimm, following long-standing methodology in merger competitive analyses, focused on junction points of the merging railroads to screen for potential reductions in source competition, which if they occurred would be horizontal effects.

CN takes issue with this approach, but just because CN has a different theory or approach does not mean that Dr. Grimm's analysis was somehow defective. There are numerous ways to analyze and review source competition alternatives. One approach, used previously by CN and (belatedly) advocated here, first identifies locations where the merging carriers each participate in at least 10% of the traffic and together participate in at least 50% of the traffic. From this initial set, locations with a bottleneck carrier (and, by extension, any locations where the merging carriers do not participate in independent alternatives) are eliminated. That set is then further reduced when intermodal competition or other competitive factors are present. In the CN/WC case, the final result was the empty set. Similarly, if that approach were applied here, the final result would also likely be an empty set. In the end, however, there is no rule or regulation that requires a merger applicant to follow CN's preferred approach and the Application was not deficient because it did not follow that approach. If CN believes that its approach is preferable, the time to present that argument is in its August 4, 2003 filing.

Given the remote possibility of an adverse source competition impact in locations other than where the merging carriers have a junction, the approach used by Dr. Grimm was clearly an appropriate and sound method to address the issue of source competition. The failure to follow the approach suggested by CN certainly was not a "defect" in the competitive analysis and the Board should reject CN's argument.

The KCS Supplement contained a similar competitive analysis of the KCS/TFM transaction with respect to both horizontal and source competition as the KCS/Tex Mex

Application. In the Supplement, Dr. Grimm discussed his views and approach to analyzing competitive issues and came to the conclusion that the KCS/TFM transaction, in conjunction with the KCS/Tex Mex transaction, would not result in any loss of independent rail routings or source competition. Thus, the Supplement served the sole purpose of “supplementing” an application that was already found to be sufficient. Adding information about the horizontal and source competitive effects of the KCS/TFM transaction could not make the Application defective. The STB should not “take CN’s bait” and reverse its prior acceptance of the Application or extend the procedural schedule because KCS did not conduct special studies and economic analysis of the type required for a “major” merger transaction when the transaction subject to the Board’s jurisdiction clearly qualifies as a minor transaction.

B. The Board Is Not Required To Analyze the KCS/TFM Transaction In Order To Accept And Proceed With The Application For The KCS/Tex Mex Transaction

1. Because The Board Does Not Have Legal Authority To Review The KCS/TFM Transaction, It Was Reasonable For The Board To Accept The Application

The Board’s determination to find that the Application was substantially complete with respect to KCS’s proposal to acquire common control of KCSR, Gateway Eastern, and Tex Mex was entirely reasonable, regardless of what was or was not contained in the Supplement. The “transaction” being reviewed by the Board, and the only transaction subject to its jurisdiction, is KCS’s common control of KCSR, Gateway Eastern, and Tex Mex. While the KCS/TFM transaction may be related to the KCS/Tex Mex transaction, it is still independent of the KCS/Tex Mex transaction. Either transaction may go forward without consummation of the other. The Board was entirely consistent as treating the KCS/Tex Mex Application as complete. As the Board recognized in *UP/CNW*, the “single, readily ascertainable event” constituting a “transaction” is what should be the subject of the Board’s approval, nothing more and nothing

less.² KCS's acquisition of Tex Mex is the "single, readily ascertainable event" which the Board could review. The Board's action in accepting the Application was entirely consistent with precedent.

On the other hand, KCS's acquisition of control of TFM is clearly outside of the Board's jurisdiction; a fact that the Board itself recognized in Decision No. 2. Decision No. 2 at n. 15, pp. 7-8, and p. 10.³ Given that the KCS/TFM transaction is outside of the Board's jurisdiction, it was entirely reasonable for the Board to accept the KCS/Tex Mex Application as sufficiently complying with its regulations governing the transaction which the Board has jurisdiction to review.

In reality, the concerns expressed by both CN and UP are not concerns about the transaction subject to the Board's jurisdiction, *i.e.* the KCS/Tex Mex transaction. Instead, CN and UP want the Board to require KCS to, in effect, submit a common control application for the KCS/TFM transaction and have the Board review that transaction. The Board should reject this approach. The KCS/TFM transaction has already been fully reviewed by the Mexican Competition Commission ("MCC") and approved. The Mexican Foreign Investment Commission ("FIC") and the U.S. Department of Justice ("DOJ") are currently also reviewing

² *Union Pacific Corporation, et al. - Control - Chicago and North Western Holdings Corp. and Chicago and North Western Transportation Company*, Finance Docket No. 32133, 1993 ICC LEXIS 183 at *20 (STB served Sept. 28, 1993) ("UP/ CNW").

³ The Board does not have any jurisdiction because TFM does not own any rail assets in the U.S., and thus does not provide "transportation in the United States" pursuant to the plain meaning of any Board or federal court interpretation of 49 U.S.C. § 10501(a)(2). Indeed, case law clarifies that the Board "lacks personal jurisdiction over...Mexican railroads and subject matter jurisdiction over the part of the transportation outside of the United States." *National Insulation Transportation Committee et al. v. Aberdeen and Rockfish Railroad Company, et al.*, 365 I.C.C. 624; 1982 ICC LEXIS 49 (ICC served Apr. 6, 1982); *see also, Western Railroads-Agreement*, 364 I.C.C. 635; 1981 ICC LEXIS 101 (ICC served Jan. 14, 1981)(if, and only if, it is clearly established that a foreign interest "operates a rail carrier *in the territory of the United States*, [then the rail carrier] must adhere to all Commission regulations." (emphasis added).

the TFM transaction. Rather than trying to get the STB to turn the KCS/Tex Mex transaction into a referendum and proceeding on the KCS/TFM transaction, CN can raise any concerns about the KCS/TFM transaction in those forums.

Indeed, if the Board were to require in this proceeding the type of information that CN would like KCS to provide with respect to the TFM transaction,⁴ and then condition the KCS/Tex Mex transaction based upon that information, it would put the Board in the position of second guessing three other agencies, the MCC, FIC, and DOJ.⁵ This would also expose the Board to taking actions that could potentially conflict with Mexico's laws and policies.⁶

2. Because The STB Does Not Review Foreign Transactions
Even If They Impact U.S. Rail Operations, It Was Reasonable
For The Board To Accept The Application As Filed

CN and UP are requesting the Board to do something that they themselves have never done. The Board knows full well that when CN undertakes a transaction purely within Canada and subject to Canadian jurisdiction, such as a line sale, an abandonment, or an acquisition of another Canadian carrier, CN does not present those transactions for the STB to "consider" whether or not that transaction will impact rail operations in the U.S., even if such transactions

⁴ Board consideration of the TFM transaction would not only be extraterritorial, but expensive, complicated, and given the quality and lack of TFM data, extremely problematic.

⁵ Review by Federal multiple agencies has been problematic in the past. See, e.g., *Sect. of Labor v. Occupational Safety and Health Review Commission, et al.*, 499 U.S. 144 (1990).

⁶ Federal courts have fastidiously sought to avoid such conflicts by refusing to find extraterritorial jurisdiction, especially when a foreign country has a greater jurisdictional claim over the transaction, such as Mexico does here. *McCulloch, Chairman, National Relations Board, et al. v. Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10 (1963); *Lauritzen v. Larsen*, 345 U.S. 571, 581 (1963); *Benz v. Compania Naviera Hidalgo*, 353 U.S. 138, 139 (1957). This refusal to assert jurisdiction over transactions implicating the U.S. and another country exists in order "to avoid unintended clashes between our laws and those of other nations which could result in international discord." *Sandra Jean Smith v. United States*, 507 U.S. 197, 204, n.5 (1993). The Board cannot and should not take a different approach.

may have an effect on U.S. rail operations, change U.S. rail operating patterns, and be related to a transaction occurring within the U.S.

When it acquired its substantial equity interest in Ferromex ("FXE"), Mexico's largest carrier and the competitor to TFM, and then began shifting traffic from the TFM interchange at Laredo to the FXE interchange at Eagle Pass or El Paso, thereby changing and impacting U.S. rail operations, UP did not perform a study and present it to the STB so that other U.S. carriers and other interested parties could comment on it. Likewise, when KCS acquired a substantial equity stake in TFM in 1997, it did not present that transaction to the STB.

Indeed, as the Board may be aware, British Columbia Rail ("BCR") is for sale and CN is a finalist for consideration as the carrier to acquire BCR. BCR connects with carriers subject to the STB's jurisdiction near the U.S./Canadian border near Vancouver, Canada. Certainly acquisition of control of BCR by an STB-regulated carrier will have impacts in the U.S. There will certainly be diversions and changed traffic patterns here in the U.S. if CN acquires BCR. Is that transaction going to be presented to the Board for review and approval? Is UP, if they are the winning bidder, going to "study the effects" of its acquisition of BCR and present that analysis to the Board? Is a NEPA analysis going to be done of such an acquisition in order to study its effects here in the U.S.? Of course, none of these things will be done and CN and UP would be the first to object to any STB review of its acquisition of BCR, a carrier not subject to the STB's jurisdiction. Yet, that is exactly what UP and CN are requesting this agency to do: require an STB analysis of a transaction not even subject to the STB's jurisdiction simply because it "may" have certain alleged effects in the U.S.

The STB knows full well that there are limits to its review and its jurisdiction and it has consistently refused to exercise its authority to rule on foreign transactions, even in the context of

a simultaneously occurring U.S. transaction. For example, when CN and CP incidentally acquired a short distance of trackage located in the U.S. through their acquisition of the Canadian properties of Conrail, the Board's predecessor, the Interstate Commerce Commission ("ICC") was careful only to exercise jurisdiction over those aspects of the transaction involving transportation in the U.S. *Canadian National Railway Company and Canadian Pacific Limited - Acquisition - Interests of Consolidated Rail Corporation in Canada Southern Railway Company and Detroit River Tunnel Company*, Finance Docket No. 30387 (ICC served Sept. 4, 1984) ("CNCP Acquisition"). Despite being requested to consider the impacts of the Canadian transaction within the context of the ICC case, the Commission specifically refused to require CN and CP to enter into certain agreements with rail carriers in the U.S. because "the interchange practices of Canadian carriers in Canada are beyond our jurisdiction." 1984 ICC LEXIS 332 at *21. The precedent applies here.

3. Long Standing Precedent Calls For The Board To Review
The Transaction Put Before It And Not Extend Its Review
To Transactions Outside The Scope Of Its Jurisdiction

By attempting to treat the two transactions as a single transaction, CN misunderstands a fundamental point. The nature of the agreements and the structure of the transactions specifically provide that each can happen without the other. Each of the agreements has independent consideration and is not contingent upon the other. KCS/Tex Mex can happen without KCS/TFM happening and vice-a-versa.

As an example, if the FIC, DOJ, and shareholders approve the KCS/TFM transaction, it will be consummated without any authority or approval from the STB, regardless of what happens to the KCS/Tex Mex transaction. It is very possible that consummation of the TFM transaction could occur before the STB even rules upon the KCS/Tex Mex transaction. If that

happens, KCS will commonly control KCSR, Gateway Eastern, and TFM. Thus, whatever alleged effects that arise out of the KCS/TFM transaction can and will arise without STB approval. In fact, regardless of whether or not the STB approves KCS's acquisition of control of Tex Mex, KCS may in fact end up with control of TFM and will through its control of TFM, indirectly own 49% of Tex Mex, as TFM does today.

Even if the STB disapproves the KCS/Tex Mex transaction or places unacceptable conditions upon the transaction, KCS can still control TFM.⁷ Indeed, under either a disapproval scenario or an unacceptable condition scenario, KCS will control TFM, assuming FIC, DOJ, and shareholder approval. On the other hand, the KCS/Tex Mex transaction, if approved, can and will happen whether or not the KCS/TFM transaction occurs.⁸ It is thus entirely proper for the Board to focus its resources and review on the KCS/Tex Mex transaction and it was thus reasonable for it to accept the Application as filed, regardless of whether or not it included information with respect to the TFM transaction.

By accepting the Application as filed, the STB understood that its primary obligation is to rule upon the transaction that is subject to its jurisdiction and to determine whether or not the Application substantially described that transaction consistent with the Board's common control or merger rules. Indeed, it would have been inconsistent with precedent for the Board to refuse

⁷ Because STB authority is permissive in nature, if the STB places unacceptable conditions upon the KCS/Tex Mex transaction, KCS does not need to consummate its control authority and has the option of divesting itself of its 51% ownership to an independent third party, while retaining a 49% indirect interest through control of TFM.

⁸ Although CN claims that TFM's call option somehow establishes that the two transactions are actually a single transaction, that call option actually proves precisely the opposite. Under the various agreements, the parties have complete flexibility to consummate either or both transactions or return the Tex Mex to its pre-transaction status quo with KCS indirectly controlling 49% of Tex Mex.

to accept the Application based upon the fact that KCS was also undertaking the KCS/TFM transaction; a transaction is outside the Board's jurisdiction and that may or may not occur.⁹

Additionally, the Board has a longstanding policy of considering individual transactions independently of other transactions or matters that involve one or more of the same companies that occur outside of the Board's jurisdiction. The Board has taken this position notwithstanding that the other non-jurisdictional transactions were taking place at the same time as related transactions that would or could eventually be subject to the Board's jurisdiction. As the ICC noted in a previous case when it held that it would not consider multiple transactions involving UP and other railroads synergistically, "our consistent policy, as approved by the courts, has been to view the competitive impacts of one merger at a time."¹⁰ Likewise, the ICC decided to confine consideration and possible approval of a control application to the specific "transaction" subject to its jurisdiction, rather than analyze the transaction in conjunction with UP's other

⁹ It is standard practice in merger transactions for the Board to refuse to consider in one transaction the speculative effects of another transaction that may or may not occur. For example, when KCS argued that the ICC should consider the competitive impacts of the BN/Santa Fe merger in conjunction with the then "speculative" UP/SP merger, UP vigorously, and successfully, contended that the Commission should not review them together, since the Commission's approval of the UP/SP transaction was "not a foregone conclusion." *Burlington Northern Inc. and Burlington Northern Railroad Company - Control and Merger - Santa Fe Pacific Corporation and The Atchison, Topeka and Santa Fe Railway Company*, Finance Docket No. 32549, Decision No. 39, 1995 ICC LEXIS 241 at *8-9 (STB served Sept. 21, 1995) (further noting that the ICC also adhered to this principle in rejecting a request to hold the UP/CNW proceeding in abeyance pending the outcome of the BN/Santa Fe proceeding). See also *Burlington Northern Railroad Company - Trackage Rights - Union Pacific Railroad Company*, Finance Docket No. 31290, 1988 ICC LEXIS 322 (ICC decided Oct. 4, 1988); *Midwestern Rail Properties, Inc. - Purchase (Portion) - Chicago, Rock Island and Pacific Railroad Company*, Finance Docket No. 29518 (Sub- No. 1), 1983 ICC LEXIS 34 (ICC decided June 16, 1983).

¹⁰ *Burlington Northern Inc. and Burlington Northern Railroad Company - Control and Merger - Santa Fe Pacific Corporation and the Atchison, Topeka and Santa Fe Railway Company*, Finance Docket No. 32549, Decision No. 39, 1995 ICC LEXIS 241 at *18 (ICC served Sept. 21, 1995) (citing *Brotherhood of Maintenance of Way Employees v. United States*, 221 F. Supp. 19 (E.D. Mich. 1963), *aff'd*, 375 U.S. 216 (1963)).

“proposed coordinations and cooperative ventures” that were either outside of the Commission’s jurisdiction or would be later presented to the agency. *UP/ CNW*, 1993 ICC LEXIS 183 at *20, n.4 (STB served Sept. 28, 1993).

Knowing this precedent, the Board was entirely reasonable in accepting the Application as fully reflecting the transaction in front of it. As the Board noted, the “transaction” over which the Board has jurisdiction was fully set forth in the Application. The Application was accepted without consideration of the information contained within the June 23, 2003 Supplement. In doing so, the Board was following its precedents. CN and UP would like this Board to ignore all of its prior precedents, ignore the fact that the Board does not have jurisdiction over the KCS/TFM transaction, and ignore the fact that the Application substantially complied with the Board’s regulations with respect to the transaction subject to its jurisdiction. The Board should reject CN’s position.

C. The Application Was Not Deficient Because It Did Not Include
A Public Interest Analysis Of The KCS/TFM Transaction

As noted, all parties and the Board agree that review of the TFM transaction is outside of the jurisdiction of the Board. Out of an abundance of caution, however, the Board asked KCS and Tex Mex to submit more information regarding TFM. KCS and Tex Mex provided that additional information on June 23, allowing the Board to proceed with its analysis. Further delay in that analysis is not warranted, as the so-called ‘public interest’ grounds relied on by UP and CN are statutory provisions that do not apply to this proceeding.¹¹ Rather, here the statute

¹¹ CN and UP continually refer to the “public interest” factors of major merger transactions, which are not applicable to this minor proceeding. CN even goes so far as to claim the Application should be rejected or additional information required because “the Board does not have a sufficient basis for determining whether the KCS/Tex Mex transaction is ‘consistent with the public interest,’ as required by 49 U.S.C. §11324(c).” CN Petition at 13. In fact, however, these arguments further establish that CN and UP are actually asking the Board to transform this

requires the Board to focus its review on protecting the public against anti-competitive effects of the transaction that is subject to its jurisdiction—the KCS/Tex Mex transaction.

D. There Are No Regulations Requiring KCS To Perform and Provide A Diversion Study Of The KCS/TFM Transaction

What appears to bother both UP and CN the most about the KCS-Tex Mex supplemental evidence is that KCS did not perform a special diversion study with respect to the KCS/TFM transaction and place that study into the record. However, CN and UP do not, and indeed cannot, point to any statute or regulation that would require KCS, or any other applicant, to perform a diversion study on the effects of a transaction that is not even subject to the STB’s jurisdiction.

The Board’s regulations and procedures for minor applications do not even require an applicant to perform diversion studies, as might normally be done in major merger applications. In fact, even in major transactions, such studies were not even required. *See* 49 C.F.R. §1180.7 (1997)(supporting data may, but need not, include diversion studies). Diversion studies have never been required in minor transactions. The reason they are not required in minor applications is simple: a minor transaction must be approved unless anticompetitive effects on shippers can be shown. 49 U.S.C. §11324(d).

As KCS explained in its Supplement, KCS never performed such a study, did not rely upon any such studies, and its financial projections and analysis with respect to the KCS/TFM transaction were not premised upon diverting substantial amounts of TFM traffic onto a commonly controlled KCS/Tex Mex. The failure to perform such a study for a transaction not even subject to the STB’s authority certainly does not qualify as a “substantially changed

“minor” proceeding into a “major” proceeding. This transaction is governed by Section 11324(d), the sole focus of which is competitive effects, not the more public interest standard of Section 11342(c).

circumstance” so as to warrant reopening Decision No. 2 to reject the KCS/Tex Mex Application; nor does it justify further delay of the proceeding and further supplementation of the record.

In the end, what CN and UP do not seem to understand is that KCS’s transaction with TFM is an acquisition of control, not a merger. If the TFM transaction receives all of the requisite approvals and is consummated, TFM will nevertheless continue to be a Mexican railroad, not merged into KCSR. TFM will continue to be headquartered in Mexico City, and will be operated from there by its current managers. It will have separate officers and a separate board of directors than KCSR. Unlike Tex Mex, for which many operations will be integrated into KCSR, TFM will continue to substantially operate in the manner that it does today.

As a result of this structure, the changes that are expected to result from KCS acquiring control of TFM are not the same as those expected in connection with the acquisition of control of Tex Mex. First and foremost, TFM will remain subject to a different set of laws – *i.e.*, the laws of Mexico – than those that will govern Tex Mex and KCSR. Second, while Tex Mex will be integrated operationally with KCSR, TFM’s operations will be coordinated with, but not integrated into, KCSR and Tex Mex. For example, Tex Mex’s marketing function will be integrated into and become a part of KCSR’s. The same will not occur with TFM. Rather, the marketing departments of TFM and KCSR will coordinate and cooperate with each other, but each will remain independently-staffed. Similarly, general and administrative functions and payroll and time-keeping functions of KCSR and Tex Mex will be consolidated, while that will not occur between KCS and TFM. The payroll, time-keeping and general administrative functions of KCS and TFM will remain separate. Such cooperation and coordination does not equate to a merger of operations. While KCSR and Tex Mex will cooperate with TFM to bring

the highest possible levels of efficiencies from their operations together, similar to the manner in which TFM cooperates with UP (TFM's major interchange partner at Laredo) to make their operations as effective as possible, TFM will not be merged into KCSR or Tex Mex. The control relationship between TFM and KCSR, accordingly, is less likely to lead to the types of changes which would result in traffic diversions than is the integration between KCSR and Tex Mex, particularly because of the continued separation of the marketing functions.

The control relationship between KCS and TFM will, therefore, be substantially different from the type of relationship for which the Board's regulations regarding transnational effects of major mergers were written, such as the CN-Illinois Central ("IC") transaction or the CN-Wisconsin Central ("WC") transaction. In both of those cases, a foreign-based carrier took over a U.S. carrier and effectively began operating the two companies as one, much the same way that KCS will operate KCSR and Tex Mex. Something substantially different, however, is occurring between KCS and TFM. While KCS is acquiring more TFM stock, it is not taking over operation of TFM. While TFM, KCSR, and Tex Mex will become more closely affiliated if the TFM transaction is approved, they will remain separate rail systems, not a single-system like CN-IC-WC in which for all intents and purposes IC and WC have ceased their independent existences.

Greater control of TFM by KCS will not cause operational changes on TFM designed to harm shippers using UP or BNSF routings to or from Laredo. TFM handles a much larger volume of traffic via connections with UP and BNSF than it does via its connection with KCSR and Tex Mex. The revenue from the UP and BNSF traffic is vitally important to TFM, and TFM would not want to jeopardize it. Should TFM attempt to take any anticompetitive actions against UP or BNSF, those carriers have the ability to route to any of a half-dozen rail gateways and to

connect with FXE. Were TFM to raise prices to shippers, shippers would choose either competing truck or barge service, or would have their shipments routed via UP or BNSF over gateway connections with FXE. In other words, it would be against TFM's self interest to exert anticompetitive efforts against UP or BNSF because those tactics most likely would result in diversion of traffic away from TFM. Instead, TFM must find ways to compete more vigorously, to improve service and to lower prices, in order to attract added traffic and increase its revenues.

For these reasons, KCS's financial analysis of the TFM transaction was based not on shifts in traffic patterns, but simply on a continuation of existing traffic and growth patterns and accommodated within existing KCSR/Tex Mex operations. These projections were used internally at KCS and externally in presentations to financial analysts, both contexts where KCS had a responsibility to present the realistic projections of the financial effects of the TFM transaction. In short, the structure of the TFM transaction is such that KCS does not anticipate traffic shifts to result from its expanded control relationship with TFM.

Even if KCS were to change its operations to try to divert additional TFM traffic to KCS-Tex Mex routings and could do so in such a way that would prevent UP and BNSF from shifting traffic away from TFM, the amount of such traffic that could be diverted is severely limited due to the fact that UP controls the infrastructure and routings of the KCSR/Tex Mex connection to TFM. Indeed, the lack of adequate infrastructure on UP's lines over which Tex Mex has trackage rights imposes a substantial practical constraint against any effort by KCS to divert substantial amounts of TFM traffic to the KCSR/Tex Mex routing. A significant portion of that track, most particularly UP's Brownsville Subdivision, is heavily congested, with traffic

exceeding even UP's estimates of track capacity most of the time.¹² Thus, UP itself constrains TFM's ability to increase KCS-Tex Mex routings by limiting the capacity of the Brownsville Subdivision and other trackage rights lines to hamper the efficiency of Tex Mex routings. Under current conditions, Tex Mex and KCS effectively cannot add further trains to carry additional cross-border traffic because the congestion on the trackage rights lines will not allow it.¹³

E. The NEPA Analysis And Safety Integration Plan Were Not Insufficient

CN also claims that the NEPA analysis and Safety Integration Plan submitted by KCS and Tex Mex are insufficient because they do not account for supposed changes in traffic patterns that will result from the TFM transaction. This claim is based on unfounded speculation by CN, and is both factually and legally unsound. CN's assertion that the KCS and Tex Mex environmental and safety analysis is insufficient is based entirely on CN's unfounded speculation that "given the much larger size of TFM, [traffic diversions resulting from KCS's control of TFM] would likely be considerably greater than those from the KCS/Tex Mex transaction alone." CN Petition, n. 11. *See also* CN Petition, n. 7. As shown above, and as discussed at length in the KCS-Tex Mex June 23 supplemental evidence, KCS's proposed control of TFM is different from the KCS-Tex Mex transaction in terms of degree of operational integration and control. Because of that difference, KCS witnesses have testified that KCS does not anticipate

¹² Despite public and contractual commitments to maintain and improve its infrastructure used by Tex Mex and BNSF under trackage rights, UP has repeatedly put off track improvements on this route, fostering the route's current congestion. This impacts Tex Mex more severely than UP, because it is the sole KCS-Tex Mex route to Mexico. UP, by contrast, primarily uses its upgraded route from San Antonio to Laredo, and has access to alternative gateways as well.

¹³ In contrast, while the KCS/Tex Mex transaction will result in a small amount of diversions to the KCSR/Tex Mex routing, those diversions do not add any additional trains, but instead only additional carloads. As the Application fully set forth, those carloads can be accommodated within the existing trainload capacity and thus will not add further congestion to an already over utilized line, *i.e.* UP's Brownsville subdivision.

traffic diversions from the TFM transaction like the modest diversion that will result from the KCS-Tex Mex transaction.

The KCS-Tex Mex environmental and safety integration presentations, consistent with the evidence contained in the June 23, 2003 supplement and consistent with KCS's financial analysis and projected future growth patterns, are premised on no significant traffic impacts resulting from the TFM control transaction. They also are consistent with the constraints imposed on Tex Mex operations by the congestion on UP's lines that are used by Tex Mex. Thus, CN's unfounded supposition that traffic on Tex Mex and KCS must increase as a direct result of the TFM transaction flies in the face of the only evidence of record on this issue. If CN or UP believe that there will be traffic pattern changes in the U.S. which will affect the environment or will affect operational safety, then they should present such evidence by the July 31, 2003 deadline for filing comments on the environmental appendix and SIP.

CN's arguments with respect to the NEPA analysis contained in the Application and the Environmental Appendix should likewise be rejected. As noted, CN's view that there must be substantial diversions in the U.S. from KCS's acquisition of control of TFM is simply not factually accurate. Furthermore, as a pure legal matter, even if KCS's acquisition of TFM were to somehow result in substantial diversions onto the KCSR/Tex Mex systems, such diversions would not require this agency to review the environmental impacts of a transaction not even subject to this Board's jurisdiction. The Board's environmental review policies result from NEPA. 49 C.F.R. 1105.1 (2002). NEPA requires environmental review of "major federal actions." *See generally* 42 U.S.C. Section 4332(c), 40 C.F.R. Section 1508.18(2002) and 49 C.F.R. Section 1105.5 (2002). A "major federal action" is one which, if not undertaken by the government directly (*e.g.*, government construction of a dam), is one which is "potentially

subject to federal control and responsibility.” *United States v. South Florida Water Management District*, 847 F.Supp. 1567, 1579 (S.D. Fla. 1992), *rev’d in part on other grounds*, 28 F.3d 1563 (11th Cir. 1994). . *See also Texas v. Ferguson, et al.*, 1992 U.S. Dist. LEXIS 20684 at *15 (W.D. Tex. 1992) [“the touchstone of ‘major Federal action’ is a federal agency’s actual power to control the non-federal activity”].

Under these authorities, the Board’s NEPA-based environmental review clearly should not and cannot extend to the TFM transaction. The TFM transaction is separate from the KCS-Tex Mex transaction. The TFM transaction involves control of a railroad operating wholly within Mexico. As the Board has already found, it does not have jurisdiction to review or approve the TFM transaction. Decision No. 2, slip op. at 8, n. 15. Because the TFM transaction is not subject to the Board’s control or approval, it is not a “major federal action,” so the Board’s authority and responsibility under NEPA do not apply to it. For this reason as well, even if there were to be impacts of the TFM transaction on train operations in the U.S., which is not the case, the Board does not have authority under NEPA to review the environmental effects of the TFM transaction.

Of course the ultimate remedy to any alleged defects in KCS’s Environmental Appendix or SIP is for CN or UP to file comments and evidence showing why that analysis was incorrect. That is what the comment period is for. Even if one assumes CN’s arguments are valid, which they are not, the Board should not reopen Decision No. 2 and reject the Application, but instead require CN to file its evidence, not make unsupported allegations and argument.

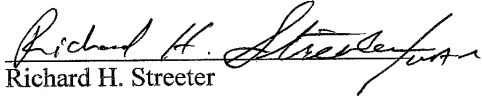
CONCLUSION

What CN claims as changed circumstances is the alleged failure by KCS to supplement the Application in the way that CN believes it should have been supplemented. UP has filed in

support of CN's arguments and conclusions. The answer to CN's and UP's concerns is not to reopen Decision No. 2 and reject the Application or, in light of applicable statutory deadlines, to extend the procedural schedule. Instead, the answer is for CN and UP to make their case when they file comments to the Environmental Appendix, the Safety Integration Plan, or on the merits of the Application itself. If CN's and UP's concerns are really directed toward the effects of the KCS/TFM transaction, then they should raise their concerns in Mexico or at the DOJ, not at the agency that doesn't even have jurisdiction to review that transaction. In the end, CN has utterly failed in its attempt to establish that circumstances have changed since the Board found that the Application was sufficient. There was no information about the KCS/Tex Mex transaction missing from the Application and the fact that the Board asked for some additional, supplemental information regarding a transaction outside of its jurisdiction does not make the original

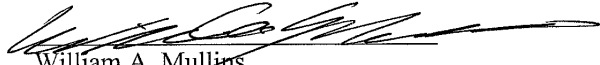
Application deficient. Indeed, filing additional evidence cannot, by its very nature, make a sufficient application insufficient. CN's request, supported by UP, should be denied.

Respectfully submitted,



Richard H. Streeter
BARNES & THORNBURG
750 Seventeenth Street, NW - Suite 900
Washington, DC 20006
Tel: (202) 289-1313
Fax: (202) 289-1330

Attorney for The Texas Mexican
Railway Company and Mexrail, Inc.



William A. Mullins
David C. Reeves
Baker and Miller, PLLC
915 15th Street, N.W. - Suite 1000
Washington, DC 20005
Tel: (202) 637-9499
Fax: (202) 637-9394

W. James Wochner
Thomas J. Healey
KANSAS CITY SOUTHERN
427 West 12th Street
Kansas City, MO 64105
Tel: (816) 983-1303
Fax: (816) 983-1227

Attorneys for Kansas City Southern,
The Kansas City Southern Railway
Company, and Gateway Eastern
Railway Company

July 21, 2003

CERTIFICATE OF SERVICE

I have this day served a copy of the foregoing Reply Of Kansas City Southern,
The Kansas City Southern Railway Company, Gateway Eastern Railway Company, And
The Texas Mexican Railway Company To Petition Of Canadian National Railway Company To
Reopen Decision No. 2 And To Reject Application upon all other parties of record by depositing
a copy in the U.S. mail in a properly addressed envelope with adequate first-class postage
thereon prepaid or by other expeditious means.

Dated: July 21, 2003.



William A. Mullins
Attorney for Kansas City Southern,
The Kansas City Southern Railway
Company, and the Gateway Eastern
Railway Company