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LOS ANGELES
NEW YORK
SAN FRANCISCO

1501 K STREET, N.W.
WASHINGTON, D.C. 20005
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711
www.sidley.com
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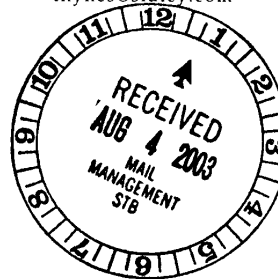
WRITER'S DIRECT NUMBER
(202) 736-8198

WRITER'S E-MAIL ADDRESS
thynes@sidley.com

208 598
August 4, 2003

By Hand Delivery

Mr. Vernon A. Williams, Secretary
Surface Transportation Board
Office of the Secretary
1925 K Street, N.W.
Washington, D.C. 20423-0001



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 Mr. Williams:

I have enclosed for filing in the above-referenced docket an original and 25 copies of the Comments of Canadian Pacific Railway Company, designated as CPR-3. Also enclosed is a diskette in Word Perfect 10 format.

Please date-stamp the two extra copies and return them to the courier. Thank you.

Sincerely,

Terence M. Hynes
Terence M. Hynes

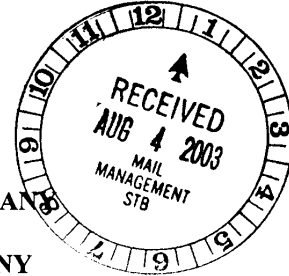
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Enclosures

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Finance Docket No. 34342

**KANSAS CITY SOUTHERN
— CONTROL —
THE KANSAS CITY SOUTHERN RAILWAY COMPANY
GATEWAY EASTERN RAILWAY COMPANY,
AND THE TEXAS MEXICAN RAILWAY COMPANY**



COMMENTS OF CANADIAN PACIFIC RAILWAY COMPANY

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Marcella Szel
Paul Guthrie
Canadian Pacific Railway Company
401 9th Avenue, S.W.
Gulf Canada Square, Suite 500
Calgary, Alberta T2P 4Z4 Canada
(403) 319-6184
(403) 319-6770 (Fax)

Terence M. Hynes
Gabriel S. Meyer
Sidley Austin Brown & Wood LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000
(202) 736-8711 (Fax)

Counsel for Canadian Pacific Railway Company

DATED: August 4, 2003

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Finance Docket No. 34342

**KANSAS CITY SOUTHERN
— CONTROL —**

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



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COMMENTS OF CANADIAN PACIFIC RAILWAY COMPANY

Pursuant to the Board's *Decision No. 2* served in the above-captioned proceeding on June 9, 2003, Canadian Pacific Railway Company and its wholly-owned subsidiaries, Soo Line Railroad Company ("Soo") and Delaware and Hudson Railway Company, Inc. ("DHRC") (collectively, "CPR") submit these comments concerning the proposed acquisition of control of The Texas Mexican Railway Company ("TexMex") by Kansas City Southern ("KCS").

CPR'S POSITION

CPR takes no position as to whether the proposed KCS/TexMex control transaction ought to be approved. However, if the Board decides to approve the proposed transaction, CPR requests that the Board condition its approval by requiring Applicants to enter into a written agreement (or agreements) that assure the future ability of rail carriers serving the "NAFTA corridor" to offer competitive interline rail service to and from Mexico via the rail gateway at Laredo, Texas.

Applicants have indicated a general willingness to "keep the Laredo gateway open on commercially reasonable terms." *See* KCS-10/TM-10, Supplement to Application at 4, 24.

Indeed, at the hearing held in this proceeding on July 31, 2003, KCS' Mr. Davies indicated that Applicants would agree to an STB condition requiring them to adhere to that representation. However, Applicants have thus far declined to identify on the record the specific measures that they would take to implement this commitment. Instead, they suggest that carriers interested in routing traffic via the Laredo gateway following the proposed transaction pursue individual discussions with KCS in order to reach "a private agreement to ensure that KCS abides by this commitment." See Attachment 1, Letter dated July 21, 2003 from Mr. Mullins to Mr. Meyer at 2. In order to maintain effective rail competition for traffic moving to and from Mexico, the Board should require Applicants to enter into an agreement (or agreements) defining the "commercially reasonable" terms upon which non-Applicant railroads (and the shippers that they serve) would be able to access the Laredo gateway following the creation of the proposed "NAFTA Railroad."

DISCUSSION

The KCS/TexMex transaction involves the acquisition by KCS, parent company of The Kansas City Southern Railway Company ("KCSR") and Gateway Eastern Railway Company ("GWER"), of a controlling stock interest in TexMex. KCS-3/TM-3, Application at 9. In a related transaction (for which KCS does not seek STB authorization), KCS also proposes to acquire from Grupo TMM, S.A. ("TMM") a controlling stock interest in TFM, S.A. de C.V. ("TFM"). TFM's rail system, which serves the major industrial and population centers of Mexico, includes that portion of the International Rail Bridge over the Rio Grande River at Laredo that lies within Mexico. *Id.* TFM currently interchanges rail traffic at Laredo with both TexMex and the Union Pacific Railroad Company ("UP").

While the Board's *Decision No. 2* accepted the KCS/TexMex control application for processing as a "minor" transaction, the Board found that "the broader transaction, incorporating the related KCS/TFM component, could be very significant." *Decision No. 2* at 10. In particular, the Board stated that "the role played by TFM in the U.S.-Mexico NAFTA corridor cannot be ignored" in considering the merits of the KCS/TexMex proposal. *Id.*¹ Indeed, TFM – and the Laredo gateway – occupy a critical position in the rapidly expanding North American trade network.

NAFTA has spawned a massive expansion in trade among the United States, Canada and Mexico. As Applicants have indicated, "[t]rade between the U.S. and Mexico is the fastest growing relationship in the world...." KCS-10/TM-10, Supplement at 13. Trade between Canada and Mexico has likewise experienced exponential growth as a result of NAFTA. Between 1993 (the year before NAFTA went into effect) and 2002, Canadian imports from Mexico increased at an annual rate of 14.6 percent. During the same period, Canada's exports to Mexico grew by 12.6 percent annually.² Applicants acknowledge that the continued growth of these NAFTA trade relationships depends upon the availability of competitive transportation alternatives. KCS-10/TM-10 at 13.

Laredo has long served as the primary rail gateway between the United States and Mexico. According to Applicants' witness Grimm, "[t]his fact is due to Laredo's superior infrastructure, such as customs brokers, and its location on the shortest route between major Mexican industrial and population centers and the Midwest and Eastern U.S." KCS-3/TM-3 at

¹ On the basis of those findings, the Board ordered Applicants to supplement their application to address the potential effects of the KCS/TFM transaction on rail competition in the United States. *Id.* at 10-11.

² Source: Statistics Canada; Ministry of the Economy (Mexico).

84, V.S. Grimm. The STB itself has recognized that Laredo “clearly occupie[s] a position of separate and surpassing economic significance” among the rail routes serving the U.S. – Mexico border. *Union Pacific Corporation, et. al. – Control and Merger – Southern Pacific Rail Corporation, et al.* (“UP/SP”), 1 S.T.B. 233, 422 (1996) (emphasis added).³ Laredo is also by far the most efficient gateway for rail traffic moving between Canada and Mexico. Nearly 90 percent of all rail traffic handled by CPR to and from Mexico currently moves via the Laredo gateway. Traffic handled to/from Mexico by Canadian National Railway Company (“CN”) pursuant to its “Alliance” with KCS likewise moves via Laredo.

The U.S. side of the Laredo gateway is served directly by both TexMex and UP. However, on the Mexican side, the gateway is served exclusively by a single carrier, TFM. (By contrast, each of the three principal U.S./Canada rail gateways – Chicago, Detroit and the Twin Cities – is served on both sides by multiple Class I railroads. This assures shippers a choice of competitive routing options through each of the major U.S./Canada gateways.) The cumulative result of KCS’ plan to acquire control of both TexMex and TFM would be to give a single rail carrier system (NAFTA Rail) control of one of the two U.S. carriers serving the Laredo gateway, as well as the only carrier (TFM) capable of providing connecting service to/from Mexico via Laredo.

CPR’s rail lines do not reach Laredo, or any other Mexican border crossing. Traffic moving between points served by CPR in the United States and Canada, on the one hand, and points in Mexico, on the other hand, must be interchanged with other carriers (primarily UP) for movement to the Mexican border. CPR is vitally interested in TFM’s continued willingness to

³ See also *UP/SP at 565* (Laredo “the premier Eastern Mexico gateway”); *Santa Fe Southern Pacific Corp. – Control – SPT Co.*, 2 I.C.C. 2d 709, 797 (1986) (Laredo “by far the most important” Mexican rail gateway); *id.* at 894-895 (“Laredo historically has been the foremost international rail gateway to Mexico”).

participate in cross-border traffic with CPR (via UP) on commercially reasonable terms. If a combined KCS/TexMex/TFM system were to close the Laredo gateway (either physically or commercially), shippers would lose the benefit of the efficient, competitive rail services offered by CPR (in conjunction with UP) in the NAFTA corridor today.

In past rail consolidation cases involving NAFTA markets, the Board has been “particularly sensitive to [its] responsibility to ensure that [the proposed transaction] will foster the goal of North American economic integration embodied in NAFTA.” *UP/SP*, 1 S.T.B. at 421.⁴ Where necessary, the Board has exercised its conditioning authority to ensure the continued vitality of rail competition for NAFTA traffic. In *UP/SP*, the Board granted TexMex trackage rights over UP’s line between Robstown and Beaumont, Texas, in order to preserve TexMex’s ability to compete (in conjunction with KCS) for U.S.-Mexico rail traffic via Laredo. *UP/SP*, 1 S.T.B. at 421-426.⁵ In the *CN/IC* control proceeding, the Board acted to prohibit interference by applicants with the ability of CPR to operate through, or make improvements to, the Detroit River Tunnel “because of the importance of the DRT to international trade.” *Canadian National Ry. Co., et al. – Control – Illinois Central Corporation, et al.* (served May 21, 1999) (“*CN/IC*”) at 35-36.

In the instant case, the Board should act to assure the continued vitality of rail competition for NAFTA traffic by imposing a condition that gives substance to Applicants’

⁴ See also Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures*, (decision served June 11, 2001) at 77 (in deciding future consolidation cases, STB to consult with relevant officials to assure that its decisions are consistent with NAFTA); Docket No. AB-545, *South Orient R.R. Co. – Abandonment and Discontinuance of Trackage Rights* (served October 6, 1998) (STB decisions should foster the goals of NAFTA).

⁵ KCS Chairman Haverty acknowledges that “the Board’s objective [has been] to ensure effective competition for NAFTA traffic at the Laredo gateway....” KCS-3/TM-3 at 56, V.S. Haverty.

commitment to keep the Laredo gateway open “on commercially reasonable terms.” Specifically, Applicants should be required to follow through on their stated willingness to negotiate a written agreement (or agreements) that would (in KCS’ words) “ensure that KCS abides by this commitment.” See Attachment 1 at 2. Such agreement(s) should apply to all “NAFTA corridor” traffic moving between points in the United States and Canada, on the one hand, and points in Mexico, on the other hand. Consistent with the Board’s expressed preference for negotiated solutions to competitive issues, the specific terms of such an arrangement can be left, in the first instance, to negotiation by Applicants and other carriers serving the NAFTA corridor.⁶ However, if the parties cannot agree on the terms of such an arrangement within a reasonable period of time, the Board should take further action to enforce KCS’ commitment to keep the Laredo gateway open following consummation of the proposed transaction.

Applicants should not object to the Board imposing such a condition. In recent rail consolidation cases, the Board has routinely required the applicant carriers to abide by any representations and commitments they make on the record. See, e.g., *Canadian National Ry. Co. et al. – Control – Wisconsin Central Transportation Corp., et al.*, (decision served September 5, 2001) (“CN/WC”) at 12-14 (condition holding applicants to representations regarding preservation of rail gateways); *CN/IC*, (decision served May 21, 1999) at 7, n. 21 (1999) (condition holding applicants to all representations made in writing and at oral argument); *CSX*

⁶ Attachment 1 (and other correspondence served upon the parties) indicates that UP and KCS may currently be engaged in private discussions regarding the terms upon which KCS would satisfy its commitment to keep the Laredo gateway open following the proposed transaction. Such an agreement could potentially resolve CPR’s concerns regarding the future of CPR-UP-TFM routings, provided that (i) the agreement applied to all traffic moving between CPR-served points and points in Mexico via Laredo, and (ii) the agreement gave CPR a right to enforce its terms, should that become necessary. CPR has advised Applicants of its willingness to work with KCS (and with UP) to establish the terms of such an agreement. (See Attachment 2, Letter dated July 29, 2003 from Mr. Hynes to Mr. Mullins.)

Corporation, et al. and Norfolk Southern Corporation, et al. – Control and Operating Leases – Conrail, Inc. et al., 3 S.T.B. 196, 387 (1998) (applicants required to adhere to all representations made during proceeding). It is equally appropriate for the Board to exercise its conditioning authority in this case to require Applicants to follow through on their commitment by entering into a written agreement (or agreements) that ensure that the Laredo gateway will remain open to all carriers on commercially reasonable terms. Given the “surpassing economic significance” of the Laredo gateway to North American trade (*UP/SP*, 1 S.T.B. at 422), the future competitive viability of interline routes connecting Mexico and the rest of the North American continent via Laredo is simply too important to leave to chance.

The condition proposed by CPR here is consistent with the policy articulated in the STB’s *Major Rail Consolidation Procedures*. The Board’s regulations for major consolidations explicitly require applicants “to present **an effective plan to keep open major existing gateways.**”⁷ While those regulations do not formally apply to this proceeding (which involves a “minor” transaction), the Board has followed a similar policy in recent “minor” cases. In *CN/WC* (which involved a “minor” transaction), the Board imposed a condition holding applicants to their commitment not to close efficient gateways. The Board also bound applicants to various representations they had made regarding the interpretation of an agreement with the National Industrial Transportation League relating, *inter alia*, to actions that applicants would take to keep active gateways open. See *CN/WC* (decision served September 5, 2001) at 12-14. Given the importance of the Laredo gateway to North American trade, the Board should likewise require

⁷ Ex Parte No. 582 (Sub-No.1), *Major Rail Consolidation Procedures*, (decision served June 11, 2001) at 24 (emphasis added).

KCS to agree to an “effective plan” to preserve rail competition via Laredo, which goes beyond the vague promises offered by Applicants to date.

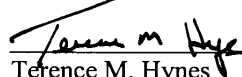
KCS’ assertion (KCS-10/TM-10 at 3, n.2) that the Board “has no legal authority” to impose a condition in this proceeding to remedy the potential anticompetitive effects of its proposal to create a combined KCS/TexMex/TFM system is incorrect. As the Board’s *Decision No. 2* correctly held, “[n]otwithstanding that [the KCS/TexMex and KCS/TFM] transactions nominally are separate and independent of each other, in reality they are two components of a single, larger transaction with broader potential implications in the U.S.” *Decision No. 2* at 11. Nor is the fact that KCS does not need STB authorization for its acquisition of TFM a bar to imposing the condition requested by CPR. In *CN/IC*, the Board rejected a similar claim by applicants that the Board lacked authority to remedy the effects of a settlement agreement entered into by applicants in connection with the transaction, simply because the settlement agreement itself was not subject to STB approval. *CN/IC* at 34. KCS’ proposal to bring TFM under common control with KCSR and TexMex is even more closely related to the KCS/TexMex application than the settlement agreement at issue in *CN/IC* was to the primary transaction in that case.

CONCLUSION

For all of the foregoing reasons, CPR respectfully requests that the Board condition its approval of the proposed transaction by requiring Applicants to enter into a written agreement (or agreements) that will assure the future ability of all North American railroads (including CPR) to route traffic to or from Mexico via the Laredo gateway on commercially reasonable terms.

Respectfully submitted,

Marcella Szel
Canadian Pacific Railway Company
401 9th Avenue, SW
Gulf Canada Square, Suite 500
Calgary, Alberta T2P 4Z4 CANADA
(403) 218-7474

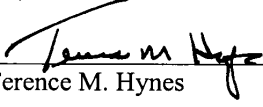

Terence M. Hynes
Gabriel S. Meyer
Sidley Austin Brown & Wood
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

Counsel for Canadian Pacific Railway Company

DATED: August 4, 2003

CERTIFICATE OF SERVICE

I hereby certify on this 4th day of August, 2003, that I caused copies of the foregoing Comments of Canadian Pacific Railway Company to be served, by hand-delivery on Applicants' counsel, and by first-class mail, postage prepaid, on all other Parties of Record.



Terence M. Hynes

BAKER & MILLER PLLC

ATTORNEYS AND COUNSELLORS

SUITE 1000
915 15TH STREET, N.W.
WASHINGTON, D.C. 20005-2318
TELEPHONE: (202) 637-8499
FACSIMILE: (202) 637-8394

July 21, 2003

BY HAND DELIVERY

David L. Meyer, Esq.
Covington & Burling
1201 Pennsylvania Avenue, N.W.
Washington, DC 20004-2401

RE: Your Letter of June 30 Regarding Kansas City Southern's Application
For Authority to Control The Texas Mexican Railway Company,
STB Finance Docket No. 34342

Dear David:

As you know, Kansas City Southern ("KCS") and Union Pacific Railroad Company ("UP") are currently in private discussions regarding UP's concerns over KCS's plans to acquire control of The Texas Mexican Railway Company ("Tex Mex") and TFM, S.A. de C.V. ("TFM"), along with other commercial issues impacting the two companies. You also know that KCS and UP have a confidentiality agreement governing those discussions. Given that background, your July 16 letter asking KCS to respond to your June 30th letter, both of which you served on all parties of record, seems more of an effort by UP to gain some sort of perceived leverage in those negotiations rather than an honest attempt to resolve UP's concerns over the two transactions. Bringing these issues into the public arena, while at the same time negotiating in private, leads one to question UP's motives and its willingness to truly negotiate in good faith.

KCS realizes that there may be other parties, in particular shippers and shipper associations, who would like some clarification of KCS's commitments made in the Application and the Supplement. KCS is talking to these parties. If it is true as you state in your letter that there are other parties unbeknownst to KCS who share UP's concerns, KCS, as always, remains willing to discuss those concerns with these parties in private. Nonetheless, if there are parties who need further clarification on the public record, KCS offers the following:

Laredo Bridge

KCS of course expects that Tex Mex and TFM will continue to cooperate with UP regarding the utilization of the International Bridge across the Rio Grande River at Laredo. As you know, operations over the International Bridge are governed by a series of

Mr. David L. Meyer, Esq.
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agreements dating back to 1951. KCS will honor all existing agreements governing operations over the bridge. In addition, KCS is willing to work cooperatively with UP toward efficient utilization of the bridge and will work in good faith with UP to develop dispatching protocols acceptable to both parties. KCS is confident that it can reach agreement with UP over such dispatching protocols as part of its private discussions with UP. Nonetheless, KCS would be willing to make its commitment to negotiate in good faith new dispatching protocols a condition of its common control of Tex Mex.

Working With UP and BNSF

As KCS has said publicly on many occasions, regardless of whether KCS obtains additional ownership in TFM, it will continue to be in TFM's best interest to work cooperatively with UP and BNSF. KCS remains committed to seeing that UP and BNSF are provided the same level of service they have experienced in the past, and to making improvements on that level of service where possible. KCS further commits that it will use its control of TFM (assuming this transaction is consummated) to require TFM to cooperate with both UP and BNSF on pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars for shipments, accommodating run-through train service, providing excellent service, and promptly quoting rates. KCS is also willing to work with UP and BNSF on development of a methodology for measuring service standards and to develop a method by which such standards could be enforced.

Keeping the Laredo Gateway Open

KCS believes that all affected parties are interested in keeping the Laredo Gateway open on commercially reasonable terms. KCS is willing to enter into private discussions with UP or any other party to discuss this commitment and reach a private agreement to ensure that KCS abides by this commitment.

Existing Tex Mex and TFM Agreements

In conjunction with this commitment, KCS will abide by all existing agreements between TFM and Tex Mex and any other carrier, including any agreements providing for rates and divisions at the Laredo gateway, until the termination date set forth in those agreements. KCS, however, is not willing to simply renew or indefinitely extend all agreements under the old terms without undertaking a good faith negotiation. KCS would not expect UP and BNSF to do so either, and does not believe that either did so in their most recent mergers. KCS is not willing to agree to an anticompetitive "freezing" of existing rates or divisions.

General Issues

Depending on the exact form any final agreement would take with respect to settlement of the foregoing issues, KCS expects to be able to agree to the imposition of its commitments on the Laredo Bridge and on working with UP and BNSF (particularly on operational monitoring) as conditions upon the STB's order approving the KCS-Tex Mex

Mr. David L. Meyer, Esq.
July 21, 2003
Page 3

transaction. However, because the Board has no jurisdiction to impose conditions on TFM, any agreements relating to TFM would have to remain a matter of contract between the parties.

UP's Commitments Regarding the Trackage Rights Lines

As you know, over the past three years, UP and Tex Mex officers have been discussing the congestion problems on UP's lines over which Tex Mex operates under trackage rights, and when UP was going to take promised steps to alleviate those problems. UP made commitments in its 1998 Infrastructure Plan, as well as contractual commitments, to maintain adequate infrastructure to prevent deterioration of service over the trackage rights lines. KCS and others do not believe UP has lived up to these commitments. So in response to your questions, KCS asks when UP is going to meet the contractual and public commitments regarding maintaining the infrastructure and transit times on the UP lines used by Tex Mex, particularly the Brownsville Subdivision?

Sincerely,



William A. Mullins

cc: The Honorable Vernon A. Williams
All Parties of Record

SIDLEY AUSTIN BROWN & WOOD LLP

CHICAGO
DALLAS
LOS ANGELES
NEW YORK
SAN FRANCISCO

1501 K STREET, N.W.
WASHINGTON, D.C. 20005
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711
www.sidley.com
FOUNDED 1866

BEIJING
GENEVA
HONG KONG
LONDON
SHANGHAI
SINGAPORE
TOKYO

WRITER'S DIRECT NUMBER
202-736-8198

WRITER'S E-MAIL ADDRESS
thynes@sidley.com

July 29, 2003

BY FACSIMILE

William A. Mullins, Esq.
Baker & Miller, PLLC
915 15th Street, N.W.
Washington, D.C. 20005-2318

Re: Finance Docket No. 34342, Kansas City Southern – Control – Kansas City
Southern Ry. Co., Gateway Eastern Ry. Co. and The Texas Mexican Ry. Co.

Dear Bill:

This letter has reference to our telephone conversation last week, during which we discussed Canadian Pacific Railway Company's ("CPR's") interest in KCS' commitment to "keep the Laredo gateway open on commercially reasonable terms" following consummation of the proposed KCS-TexMex control transaction. (See KCS-10/TM-10, Supplement to Application at 4, 24.) In particular, we discussed KCS' suggestion, set forth in your July 21, 2003 letter to Mr. Meyer (the "July 21 Letter"), that interested parties enter into discussions with KCS aimed at reaching "a private agreement to ensure that KCS abides by this commitment."

CPR believes that a written agreement could be an effective means of providing substance to KCS' representations regarding the future of the Laredo gateway, and resolving CPR's concerns about the proposed transaction. However, as you know, CPR does not serve Laredo directly. Rather, CPR must rely upon connecting carriers (primarily UP) to handle CPR's Mexican traffic to/from TFM. Thus, a bilateral arrangement between CPR and KCS alone would not be effective in resolving CPR's concerns unless KCS had reached a similar arrangement with those connecting carriers as well.

Your July 21, 2003 letter suggests that KCS may currently be engaged in discussions with UP regarding the terms of an agreement relating to KCS' commitment to keep the Laredo gateway open. Such an agreement might create a basis for resolving CPR's concerns regarding the future of CPR-UP-TFM routings, provided that (i) the agreement applied to all traffic moving between CPR-served points and points in Mexico via Laredo, and (ii) CPR had a right to enforce the terms of the agreement, should that become necessary. One way to accomplish this result would be for CPR to become a signatory to a prospective KCS-UP agreement. (CPR recognizes

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WASHINGTON, D.C.

William A. Mullins, Esq.

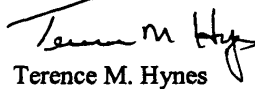
July 29, 2003

Page 2

that UP's concurrence would be required to implement this solution.) Alternatively, a KCS-UP agreement might include provisions that extended its terms to CPR-UP-TFM routings via Laredo, and granted CPR the independent right to enforce the agreement if necessary.

Please advise at your earliest convenience whether KCS is willing to discuss with CPR the terms of an agreement that would assure TFM's future participation in CPR-UP-TFM routings on commercially reasonable terms, either by making CPR a signatory to any agreement between KCS and UP relating to the Laredo gateway, or by some other mutually acceptable means. If such an arrangement can be reached, CPR would be in a position to support the proposed transaction.

Sincerely,

A handwritten signature in dark ink, appearing to read "Terence M. Hynes", with a stylized flourish at the end.

Terence M. Hynes

cc: David L. Meyer, Esq.