



**U.S. Department of
Transportation**

Office of the Secretary
of Transportation

GENERAL COUNSEL

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Washington, D.C. 20590

208 612

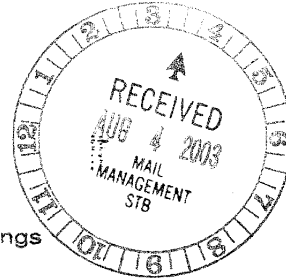
August 4, 2003

Vernon A. Williams, Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001

ENTERED
Office of Proceedings

AUG - 4 2003

**Part of
Public Record**



Re: Finance Docket No. 34342

Dear Mr. Williams:

Enclosed please find an original and twenty-five copies of the "Initial Comments of the United States Department of Transportation" in Finance Docket No. 34342. Also enclosed is a diskette containing a version of our comments saved in WordPerfect.

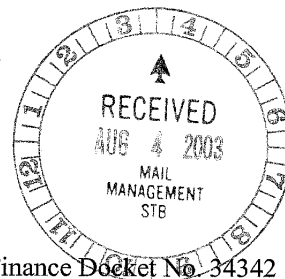
We have also enclosed a service copy of our comments, and would appreciate it if you would time-stamp that copy and return it to the courier delivering our comments.

Sincerely,

Dale C. Andrews
Deputy Assistant General Counsel
for Litigation

cc: All parties of record

**Before the
Surface Transportation Board
Washington, D.C.**



_____)
 Kansas City Southern -- Control -- The Kansas City
 Southern Railway Company, Gateway Eastern
 Railway Company, and The Texas Mexican
 Railway Company
 _____)

Finance Docket No. 34342

**Initial Comments of the
United States Department of Transportation**

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Introduction

The Surface Transportation Board ("Board" or "STB") in this proceeding is considering (1) the application of the Kansas City Southern Railway Company and related entities (collectively referred to herein as "KCS") to acquire control of the Texas Mexican Railway Company ("Tex Mex"), and (2) the implications for the United States of a related transaction: KCS's acquisition of a large Mexican railroad -- TFM, S.A. de C.V. ("TFM").¹ The combination of these three carriers would form a coordinated international rail system called NAFTA Rail.

The United States Department of Transportation ("Department" or "DOT") notes that the relevant record at this point contains only the original application, a supplement ordered by the STB to address the implications of the TFM transaction, and objections to

^{1/} KCS and Tex Mex are referred to herein collectively as "Applicants." The first transaction above is referred to herein as the "Tex Mex transaction" and the second as the "TFM transaction." The details of all the relevant corporate relationships and the complicated series of interrelated transactions among the corporations involved are summarized in Decision No. 2 at 3-7.

the adequacy of that supplement.² In the absence of additional development of factual and legal issues through the submissions of other parties, and pending the Board's ruling on the outstanding objections, there is as yet an insufficient basis for DOT to take a position on the merits of the transaction. Consistent with past practice, and with the schedule adopted for this proceeding, in these circumstances we will review the initial comments of other parties before expressing our substantive views on reply.³

The Department offers its preliminary comments below. They are based only upon the information that the Applicants have submitted to date. We take no position on the merits of the objections filed regarding the adequacy of that record as regards the TFM transaction. Should the Board direct the Applicants to submit additional information and/or analyses, DOT may modify its views.

The Applicants

KCS is a Class I railroad that owns or operates approximately 3,100 miles of track in a mostly north-south configuration through ten Midwestern and Southern states.⁴ Its principal lines extend from Kansas City via Shreveport, Louisiana, to New Orleans, Alabama, Dallas, and Port Arthur/Beaumont, Texas. KCS-3/TM-3 at 18-19, 36. KCS also offers service via haulage rights to Chicago, Houston, and Omaha/Council Bluffs over the lines of UP and the Burlington Northern and Santa Fe Railway Company

^{2/} The Applicants have also submitted an Environmental Appendix and a Safety Integration Plan (KCS-10/TM-10), which DOT has already addressed. DOT-2 (filed July 31, 2003).

^{3/} Finance Docket No. 34342, Decision No. 2 (served June 9, 2003). The Department appreciates the Board's modification of the proposed procedural schedule.

^{4/} Kansas, Missouri, Illinois, Oklahoma, Arkansas, Texas, Louisiana, Mississippi, Tennessee, and Alabama.

("BN").⁵ KCS connects at different points throughout its system with all other Class I railroads.

The Tex Mex is a Class II railroad that owns and operates 157 miles of track between Laredo and Corpus Christi, Texas. KCS-3/TM-3 at 18. It also operates over trackage rights on the Union Pacific Railroad Company ("UP") to connect with KCS at Beaumont, Texas. Tex Mex also interchanges traffic with BN. Tex Mex is wholly owned by Mexrail, a noncarrier whose other asset is the U.S. portion of the International Railroad Bridge at Laredo that crosses into Mexico. *Id.* at 10, note 1.

TFM is a large railroad located entirely within Mexico. KCS-10/TM-10 at 22 note 15.⁶ It operates to Matamoros and Nuevo Laredo on the U.S./Mexican border and thence south to Mexico City; it also reaches to Veracruz and Tampico on the Gulf of Mexico and to Lazaro Cardenas on the Pacific Ocean. KCS-10/TM-10, Exhibit 1. KCS and Grupo TMM (a Mexican company) purchased 80 percent of TFM from the Government of Mexico in 1996. KCS-10/TM-10 at 8. At the conclusion of a complicated series of transactions, this portion of TFM would be wholly owned by NAFTA Rail. *See* KCS-3/TM-3 at 14.

⁵/ KCS's corporate parent, Kansas City Southern, also owns the Gateway Eastern Railway Company ("GWER"). GWER is a Class III carrier that owns and operates approximately 17 miles of track in Illinois; it primarily serves as an industrial switching railroad in the areas of Alton and Wood River, Illinois. KCS-3/TM-3 at 19.

⁶/ DOT includes a brief description of TFM because, although it is not technically an applicant, the Board has properly determined to examine whether and to what extent the TFM transaction will have competitive or other implications for the U.S. Decision No. 2 at 11.

Applicants' Public Interest Considerations

The Applicants contend that their transactions would advance the public interest in numerous ways. They urge that it would result in a seamless, financially stronger North American rail system that would introduce greater operating efficiencies, improve service to shippers, and extend single line service to new markets. KCS-3/TM-3 at 17-18, 23, 28, 30 and Verified Statement ("VS") of Michael Haverty at 61-65; KCS-10/TM-10 at 8-9, and VS of Gerald K. Davies at 3-4.

The Applicants assert as well that, rather than having no adverse impact on competition, their combination, and that of TFM, would in fact enhance competition with Class I railroads and other modes of transportation. KCS-3/TM-3 at 17-18, VS of Curtis M. Grimm at 82; KCS-10/TM-10 at 10-19, VS Davies at 5-13, and Supplemental VS ("SVS") of Grimm at 2. They stress that KCS has owned significant equity interests in Tex Mex and TFM for some time, that the carriers have coordinated their operations to a significant extent already, and that no adverse competitive consequences have resulted. KCS-3/TM-3 at 12-14, VS Haverty at 58; KCS-10/TM-10 at 7, 31, SVS Grimm at 2-3. They point out that both the Tex Mex transaction and the TFM transaction are entirely "end-to-end" in nature, and that no shipper would lose competitive rail service or access to routing options. KCS-3/TM-3, VS Grimm at 77-81; KCS-10/TM-10, at 10-19, and SVS Grimm at 2-3. The Applicants report that they serve no common industries, that KCS and Tex Mex interchange traffic only at Beaumont, and that Tex Mex and TFM connect only at Laredo. KCS-10/TM-10 at 12. Common control, they aver, would not lead to meaningful changes in any pertinent regard. KCS-10/TM-10, VS Davies at 16-18.

The Applicants have also pledged to honor existing contractual agreements with other railroads. KCS-10/TM-10 at 24-27, and VS of Davies at 14. This includes commitments, for example, to abide by the terms of intercarrier agreements governing operations on the Laredo International Bridge as well as marketing arrangements with CN and Norfolk Southern. KCS-3/TM-3 at 27; KCS-10/TM-10 at 24-27. The Applicants do not, on the other hand, promise to extend all existing contracts without change. When these contracts expire the Applicants intend to review them, and those that do not provide adequate revenue will be renegotiated or not renewed. KCS-3/TM-3 at 27; KCS-10/TM-10 at 24-27. The Applicants include statements of support from shippers, railroads, and government entities. KCS-3/TM-3 at Appendix A.

Objections to the Application

Two Class I rail carriers have urged the STB to reject the application on the grounds that the Applicants have not provided complete information on the full implications of the TFM transaction. The Canadian National Railway Company (“CN”) contends that the supplement does not offer the requisite “full system” competitive analyses and operating plans, that the Applicants used a “static model” in their analyses (which erroneously assumes no change in traffic growth), and that the proffered analysis of source competition is faulty. CN-3.⁷

The Union Pacific supports CN. UP-4. UP asserts that the present record does not allow for a thorough understanding of the implications of the TFM transaction for the

⁷/ CN also avers that the shortcomings of the supplement prevent the Board from examining the “cumulative impacts” of this related transaction under the National Environmental Policy Act (“NEPA”). Id. at 11-12.

U.S. because the supplement is analytically flawed, it does not comply with the Board's order, and it is inconsistent with statements allegedly made by the Applicants in other contexts. UP-4 at 4-7. UP maintains that it is concerned not with any pro-competitive traffic shifts generated by either transaction, but only with those that might arise from anticompetitive motives. UP believes that there is an "unusually acute danger[]" that the TFM transaction in particular will result in NAFTA Rail's disfavoring of traffic exchanges between TFM and UP, constricting UP's access to the Laredo Bridge, and otherwise "tilt[ing] the competitive playing field" to UP's disadvantage. UP-4 at 3.⁸

DOT's Preliminary Comments

The role of the Department in this proceeding is premised on the statutory and regulatory provisions that govern this transaction, as well as on DOT's statutory responsibilities as the Executive Department of the United States established by Congress "to provide general leadership in identifying and solving transportation problems,"⁹ to the end that the Secretary of Transportation "shall provide leadership in the development of transportation policies and programs."¹⁰

The Department submits that, pursuant to applicable statutory provisions,¹¹ the following issues warrant consideration in this proceeding:

⁸/ The Applicants view UP's concerns as utterly unfounded in light of that carrier's much larger size overall, its domination of rail traffic at Laredo in particular, its continuing importance to the carriers that would comprise NAFTA Rail, and the Applicants' commitment to observe the terms of existing agreements with other railroads. KCS-10/TM-10 at 22, 24-27, and VS of Davies at 5-16.

⁹/ 49 U.S.C. § 101(b)(5).

¹⁰/ 49 U.S.C. § 301(2).

¹¹/ 49 U.S.C. § 11324(d).

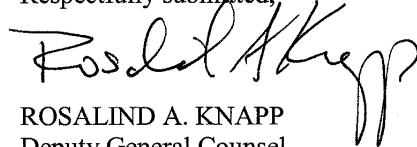
- Whether the transaction is likely to substantially lessen competition, create a monopoly, or restrain trade in freight surface transportation in any region of the country; and
- Whether the transaction's anticompetitive effects outweigh the public interest in meeting significant transportation needs.

Parties have questioned whether the Applicants have provided the record with complete and accurate information on the full implications of the TFM transaction. If the record is not complete, the Board cannot assess the transaction's true effects on competition, and so would be unable to resolve the requisite statutory issues. DOT takes no position on this dispute, but agrees that the STB should address this question as a threshold matter.

Conclusion

The Department appreciates this opportunity to participate in a proceeding of such significance to railroads, shippers, and the general public. We look forward to the further development of the record and to contributing to a sound final decision.

Respectfully submitted,



ROSALIND A. KNAPP
Deputy General Counsel

August 4, 2003

STB FILINGS

July 31.

Finance Docket 34342 (NAFTA Rail case). DOT Comments on Environmental Appendix and Safety Integration Plan.

August 4.

Finance Docket 34342 (NAFTA Rail case). DOT Initial Comments

Finance Docket 33388 (Sub-No. 91) (Conrail Oversight case). DOT Reply Comments.

Administrative

All STB filings require the **original and twenty-five copies** to the STB, as well as an electronic version on a **diskette** (convertible into WordPerfect).

The environmental/safety filing above should be addressed as follows:

Office of the Secretary
Case Control Unit
Finance Docket No. 34342
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

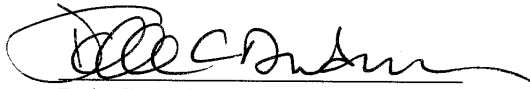
Attention: Phyllis Johnson-Ball
Environmental Project Manager
Environmental Filing

The others should be addressed as follows:

Vernon A. Williams, Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001

Certificate of Service

I certify that on this date copies of the foregoing document were served on all parties of record in this docket by first class mail, postage prepaid.

A handwritten signature in black ink, appearing to read 'Dale C. Andrews', written over a horizontal line.

Dale C. Andrews
Deputy Assistant General Counsel
for Litigation
United States Department of Transportation

August 4, 2003