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August 4, 2003

The Honorable Vernon A. Williams
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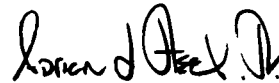
Re: Finance Docket No. 34342, *Kansas City Southern*
– *Control – The Kansas City Southern Ry.,*
Gateway Eastern Ry. & The Texas Mexican Ry.

Dear Secretary Williams:

Please find enclosed for filing in the above-captioned proceeding the original and twenty-five (25) copies of Comments of The Burlington Northern and Santa Fe Railway Company (BNSF-4). Also enclosed is a 3.5 inch disk containing the text of the pleading in WordPerfect 9 format.

I would appreciate it if you would date-stamp the enclosed extra copy and return it to the messenger for our files.

Sincerely yours,



Adrian L. Steel, Jr.

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Enclosures

cc: All Parties of Record

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

COMMENTS OF
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

ENTERED
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AUG 05 2003

**Part of
Public 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

COMMENTS OF
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

Pursuant to Decision No. 2 in this proceeding, The Burlington Northern and Santa Fe Railway Company ("BNSF") hereby submits its comments on the proposed Kansas City Southern ("KCS")/Texas Mexican Railway Company ("Tex Mex") control transaction.

INTRODUCTION AND SUMMARY

BNSF's interest in the KCS/Tex Mex/NAFTA Rail transaction is to ensure that rail shippers who rely on BNSF to provide them access to south Texas and Mexican markets are not competitively worse off as a result of the transaction. KCS has made a number of pledges and commitments to the Surface Transportation Board ("STB" or "Board") and others which address many of BNSF's concerns – including at the Board's July 31, 2003 public hearing, where KCS stated that it would accept as a condition to the Board's approval of the KCS/Tex Mex transaction a requirement that the Laredo and

Brownsville gateways be kept open on commercially reasonable terms.¹ As a result, BNSF supports the KCS/Tex Mex/NAFTA Rail transaction, subject to clarification of those pledges and commitments and to their inclusion as conditions in the Board's final decision. BNSF believes that the transaction could result in a stronger interline connecting carrier with which BNSF could work to enable it to provide better competition.

The proposed KCS/Tex Mex/NAFTA Rail transaction raises greater competitive issues and policy concerns than would be typical for a primarily end-to-end merger involving a Class II carrier. These concerns arise from the unique and important position that Tex Mex plays in international trade and from the anticipated second-stage acquisition of TFM, S.A. de C.V. ("TFM") by KCS, creating an international single system NAFTA Rail network.

In addition, BNSF plays a special role regarding its customers' traffic moving via Laredo and Brownsville. BNSF obtained access to those gateways in the UP/SP merger proceeding as a replacement for Southern Pacific ("SP") in order to provide a competitive counterweight to Union Pacific ("UP") for U.S.-Mexico traffic. Thus, it is

¹ KCS also announced at the hearing that it had reached an agreement with The National Industrial Transportation League ("NIT League") which respect to issues relating to the proposed transaction but did not make details of the agreement public. Accordingly, BNSF has not had an opportunity to review and analyze the agreement, and BNSF will provide its views on the agreement in its September 2, 2003 reply comments.

important that, if the transaction is approved, BNSF's competitive capability to fill that role for its customers continue on an undiminished basis.²

In BNSF's view, the key issue for preserving competition for U.S.-Mexican rail traffic is the maintenance of meaningfully open gateways through Laredo and Brownsville including, in BNSF's unique case, its ability to reach Laredo via Tex Mex through Robstown. Otherwise, shippers may be forced to use less efficient and more costly routes, or switch to other transportation modes, for their Mexican traffic as their only alternative to UP. The Board recognized in its revised merger rules in Ex Parte No. 582 (Sub-No. 1)³ that major existing gateways should be kept open in future mergers, both physically and economically.

The conditions the STB imposed on the UP/SP merger to protect shippers gave BNSF the right to connect with Tex Mex as a neutral bridge carrier, capable of interlining with both BNSF and KCS in competition with UP for traffic to and from the Laredo gateway. BNSF has gained a relatively small percentage of the traffic moving through Laredo, but it helps effectively constrain the rates through that gateway. It is significant to note that KCS reported to the Board in its control application that, small as

² As KCS has stated in its pleadings to the Board and in various communications to shippers, the Board also provided Tex Mex with trackage rights over UP/SP lines to connect with KCS at Beaumont, TX in order to ensure the continuation of effective competition at Laredo. *Union Pacific Corp. – Control and Merger – Southern Pacific Rail Corp.*, 1 STB 233, 421-426 (1996) (“*Decision No. 44*”). However, as the Board noted, Tex Mex's trackage rights were to be, in Tex Mex's own view, “an addition to [the] competitive safeguards contained in the BNSF agreement, and not . . . a replacement.” *Id.* at 147.

³ *Major Rail Consolidation Procedures* (served June 11, 2001) (“*June 11 Decision*”).

BNSF's share of the Laredo international market is, BNSF nonetheless was Tex Mex's largest interline partner in terms of volume in 2002. While KCS is a vital part of the nation's rail system, it does not have the route structure or market reach to provide the competitive presence that BNSF can and does provide to and from major gateways and throughout the western United States. The diminution of Tex Mex as a neutral non-controlled bridge carrier could weaken the competitive discipline that BNSF provides to UP over the Laredo gateway. BNSF must be able to continue to be a competitive alternative for shippers to UP as a replacement for SP pursuant to the UP/SP merger conditions.

The Board's conditions were also premised on TFM's provision of rates and services over the international gateways of Laredo and Brownsville to and from points in Mexico that permit BNSF to be competitive, and the failure by TFM to do so would similarly adversely affect BNSF's ability to competitively serve shippers.

It is clear that the STB has jurisdiction over the Laredo and Brownsville gateways, within the context of this integrated transaction for control of both Tex Mex and TFM. The STB can exercise its conditioning power to address competitive issues on international traffic over an established international gateway. It does not have direct jurisdiction over TFM's operations within Mexico, but it can require the U.S. controlling company – NAFTA Rail – to ensure commercially reasonable open gateways for international traffic over Laredo and Brownsville.

In statements to the Board on several occasions, KCS has made a series of commitments and pledges and has given reassurances that it would continue to work with BNSF over these international gateways and that it would honor all existing Tex

Mex and TFM marketing and pricing agreements. KCS has also said it will keep the Laredo and Brownsville gateways open on commercially reasonable terms and that all carriers will be treated fairly at the Laredo Bridge. BNSF believes these commitments on service and commercial access need to be made more specific and imposed as conditions for approval of KCS' control of Tex Mex now pending before the Board.

Accordingly, BNSF's support of the NAFTA Rail transaction proposed by KCS and Tex Mex is premised on the Board ensuring through conditions that KCS/Tex Mex will be required to provide commercially reasonable rates and service to BNSF between Laredo and Robstown and that KCS/TFM will be required to provide rates and service for BNSF traffic moving via Laredo and Brownsville to and from Mexico which do not disadvantage shippers who would choose BNSF's offerings in comparison to other routing alternatives.⁴

BNSF does not seek the imposition of something cumbersome or particularly complex. In accord with the kind of condition the STB imposed in the CN/Wisconsin

⁴ BNSF is not alone in this regard. A number of the shippers who appeared at the Board's July 31st hearing or who have filed written submissions with the Board have noted the importance of requiring KCS to maintain open gateways at Laredo and Brownsville on commercially reasonable terms and/or imposing a condition to that end on the Board's approval of the transaction. These shippers include: AK Steel Corporation; CWS, Incorporated; Dal-Tile; E.I. du Pont de Nemours and Company; Griffin Industries, Inc.; Hub Group, Inc.; Lason Grain Company; Kimberly-Clark de Mexico, S.A. de C.V.; Pacesetter Steel Service, Inc.; Reagent Chemical & Research, Inc.; Unimin Corporation; and Weyerhaeuser Company. Indeed, one of those shippers – Hub Group, Inc. – has recently supplemented its prior April 28, 2003 letter of support to the Board to clarify that it "strongly supports conditions that will guarantee continued competitive and efficient . . . rail service via the Laredo gateway." Letter from Thomas L. Hardin, Hub Group, Inc., to Secretary Williams, dated July 17, 2003

Central transaction⁵ to implement those parties' agreement with NIT League, one tested, workable approach would be for the Applicants to be required to maintain the existing Tex Mex and TFM rates and services presently available for service in conjunction with BNSF at Laredo, Robstown/Corpus Christi and Brownsville for a temporary five-year period, subject to RCAF-U increases, and to provide commercially reasonable rates and services thereafter subject to the jurisdiction of the Board. Such an approach would provide a transitional time period for the development of effective interline routing and commercial relationships in light of the transaction. BNSF does not believe that a condition should preclude the new system from properly exploiting whatever competitive efficiencies and benefits it could bring to the shipping public as a result of its transaction. Thus, if the new system can offer lower rates and better service to rail shippers as a result of its extended system, then it should be free to do so.

Such a condition would reflect the Board's adoption of open gateway requirements in the revised merger rules. It would also be consistent with open gateway agreements in prior merger proceedings and would preserve BNSF's ability to offer effective competition to its customers as a replacement for SP pursuant to the UP/SP merger conditions. Such an approach would also be consistent with the position taken by KCS in Ex Parte No. 582 (Sub-No. 1) that all existing competitive shipper rail options should be preserved in future merger or control transactions.

A measured approach can make the benefits of the proposed NAFTA Rail transaction available to the Applicants and shippers, while preserving competitive

⁵ *Canadian National Ry. Co. – Control – Wisconsin Central Transp. Corp.*, Finance Docket No. 34000.

alternatives and shipper options, so that ultimately shippers can choose the services they desire.

ARGUMENT

To ensure that there will not be a substantial lessening of competition for traffic moving between the U.S. and Mexico via the Laredo and Brownsville gateways as a result of the proposed KCS/Tex Mex/NAFTA Rail transaction, the Board should condition its approval of the transaction on NAFTA Rail maintaining commercially open gateways at Laredo and Brownsville and maintaining existing rates, subject to RCAF-U adjustments, during a five-year transition period. As shown below and in the Verified Statements of Peter J. Rickershauser ("Rickershauser V.S.") and David Reishus ("Reishus V.S.") submitted herewith, such a condition is necessary to ensure that, in the interim and over the long term, there continues to be effective competition at those two critical international gateways. Such a condition is well within the authority of the Board and is consistent with the Board's past practices and its new rules for mergers. Moreover, because KCS has already agreed and committed to maintain open gateways on commercially reasonable terms at those gateways, such a condition would not adversely affect NAFTA Rail.

I. **IT IS CRITICAL TO ENSURE THAT TRAFFIC FLOWS FREELY AND COMPETITIVELY THROUGH LAREDO AND BROWNSVILLE**

A. **Laredo And Brownsville Are Important Gateways For NAFTA Traffic**

Laredo is the most important Mexican gateway, and maintaining an open gateway at Laredo is critical for ensuring the free flow of goods between the U.S. and Mexico. As the Board recognized in the UP/SP merger proceeding, Laredo constitutes a market of "separate and surpassing economic significance" superior to other

gateways. Decision No. 44 at 422. In fact, Laredo accounts for 75% of the value of all rail traffic between the U.S. and Mexico (Reishus V.S. at 4), with overall traffic between the U.S. and Mexico growing over 300% since 1994 (*Id.*, Figure 1).

Laredo is a critical gateway for several key commodities and products. BNSF alone shipped over 13,000 rail cars of grain, 14,000 rail cars of industrial products, 5,000 rail cars of motor vehicles and auto parts, and 3,000 rail cars of intermodal traffic through Laredo in 2002 (Rickershauser V.S., Exhibit 1), and BNSF constitutes only 8% of the total Laredo traffic (Reishus V.S. at 7). Laredo is a key gateway for at least three reasons. First, "Laredo is located on the most direct route between the major population and industrial centers of Mexico City and Monterrey and the central and eastern U.S." Reishus V.S. at 4. Second, the infrastructure that has been built up at Laredo to handle significant traffic volumes on a timely basis makes Laredo one of the most efficient rail gateways to and from Mexico. Third, Laredo is the principal juncture with TFM, which "has exclusive access on the Mexican side of the Northeastern Mexican gateways of Laredo/Nuevo Laredo and Brownsville/Matamoros and reaches the important industrial centers of Mexico City and Monterrey." *Id.*

Brownsville, though carrying less traffic than Laredo, is still a significant gateway for traffic to and from areas of northeastern Mexico it can efficiently serve, particularly for grain processors and other producers near the Mexican border. "BNSF has also increased traffic over its Brownsville route by 250% over the 1996-2002 time period, with over 10,000 cars exchanged at the Brownsville gateway in 2002." Rickershauser V.S. at 4. For example, 60-70% of BNSF's traffic to Brownsville serves a single receiver – Regasa. Rickershauser V.S. at 23. If the Brownsville gateway were to be no longer

open on commercially reasonable terms, Regasa could only receive its soybean shipments through UP, or via barge or truck. *Id.* Such a diversion would nearly eliminate BNSF as a competitor to UP for this traffic, and would likely also mean that the U.S. shippers that served Regasa via BNSF would be replaced by new shippers. *Id.*

B. BNSF Is A Critical Competitor At The Laredo Gateway

Rail traffic to the Laredo gateway is dominated by UP. UP carried 84% of the traffic at Laredo in 2001. *Reishus V.S.*, Figure 3. UP enjoys a more direct route to Laredo; its density on its shipments to Laredo provides it a lower cost structure; and its broad coverage area permits it to serve more customers at that gateway than other carriers. *Rickershauser V.S.* at 15, Exhibit 2.

The Board conditioned the UP/SP merger on BNSF being granted trackage rights over UP's track to enable BNSF to reach Tex Mex and to serve as an effective competitive replacement to SP for traffic going through Laredo. To further the Board's goals, BNSF has invested heavily to compete for traffic going through Laredo. See *Rickershauser V.S.* at 4. Since the Board's decision in 1996, BNSF has invested over \$20 million in marketing BNSF's service to and from Mexico. *Id.* BNSF has added 7-10 additional trains each way per week, it has developed efficient unit grain train services, and it has developed value-added services, such as its Mexi-Modal service and integrated dock-to-dock carload pricing and service. *Id.*

As a result of its efforts, BNSF provides effective competitive discipline to UP. BNSF, operating through an agreement with Tex Mex, accounts for the majority of the non-UP traffic going through Laredo, and in 2002 BNSF shipped 38,800 cars through that gateway. *Rickershauser V.S.*, Exhibit 3. BNSF has increased its traffic through Laredo 87% since 1996, driven largely by growth in grain traffic (258% growth),

industrial traffic (154% growth), and intermodal traffic (156% growth). *Rickershauser V.S.* at 4-7. In fact, “[d]espite UP’s dominant share of traffic over Laredo, BNSF carries over a quarter of the Laredo gateway traffic to and from the tier of grain belt states from Oklahoma to North Dakota.” *Reishus V.S.* at 12 (footnote omitted). BNSF is able to compete for this traffic because of BNSF’s broad geographic reach, its ability to offer value-added services, and its reasonably efficient routings to Laredo. *Rickershauser V.S.* at 8-9. By contrast, KCSR, which provides only 5% of traffic to Laredo, has neither the geographic reach nor the efficient routings that would permit it to pose a competitive threat to UP. *Id.* Because BNSF is the only carrier that can provide full replacement competition against UP at Laredo, maintaining BNSF’s access to Laredo at competitively reasonable rates is critical for ensuring effective competition for shippers.

As Mr. Rickershauser states, since the Board’s decision in the UP/SP merger:

BNSF has demonstrated that it can provide effective competitive discipline to UP for traffic destined for the Laredo and Brownsville gateways. Developing that level of competition, though, has required substantial investment on the part of BNSF throughout its network to support Mexican business flows and provide competitive, marketable service offerings for shippers, and has required BNSF to leverage all of its competitive advantages, from its broad geographic reach and extensive interline connections to its dedicated drive to achieving efficiencies and reducing shipping costs. In addition, BNSF’s ability to provide effective competition to UP depends on the provision of commercially reasonable rates and services by both the Tex Mex and TFM, and its ability to continue to provide shippers with that competition is dependent on the continuation of such rates and services.

Rickershauser V.S. at 9. Unless BNSF continues to receive commercially reasonable rates and service from both Tex Mex and TFM, the proposed transaction could jeopardize the progress BNSF has made in providing customers relying on it a competitive alternative to UP.

II. ABSENT AN OPEN GATEWAY CONDITION, THE PROPOSED TRANSACTION MAY REDUCE COMPETITIVE OPTIONS AT LAREDO

Absent the imposition of an open gateway condition, the new NAFTA Rail could impose competitive restraints that would reduce competitive options at Laredo and Brownsville. KCS' control over both Tex Mex and TFM would give KCS numerous opportunities to restrict competition through the Laredo gateway, and KCS' comments in this proceeding and its past conduct suggest that the new NAFTA Rail may well avail itself of its options.

First, the new NAFTA Rail will have multiple options for restricting competition through the Laredo gateway. As stated in Mr. Rickershauser's Verified Statement, KCS could discriminate against its competitors in the following ways:

- KCS could raise rates at Robstown for any traffic going over Tex Mex unless it originates from the KCS system or is routed to give KCS its longest haul.
- KCS could raise rates at Laredo for any traffic going over TFM that again does not originate from the KCS/Tex Mex system or does not give the system its longest haul.
- KCS could discriminate against competing carriers on TFM by charging higher bridge fees or by reducing the crossing access that it would charge itself.
- KCS could cause TFM and Tex Mex to discontinue providing value-added services (such as blocking traffic, providing equipment or providing intermodal service) to KCS' competitors, preventing those carriers from offering fully-competitive services.

Rickershauser V.S. at 11.

Second, based on its filings to date and from its past conduct, KCS has effectively acknowledged that it intends to raise rates on BNSF traffic over Tex Mex. In their Application to the Board, the Applicants stated that they may not renew "agreements that would not provide adequate revenues to a combined KCSR/Tex Mex

system.” Application at 27, n.19. The BNSF/Tex Mex 1998 interline divisional agreement, which is up for renewal at the end of 2003, appears to be one of the contracts to which the Applicants refer. Further, as KCS stated in response to a discovery request, KCS has told BNSF that it “need[s] to improve the overall revenue/expense ratio for Tex Mex of handling BNSF traffic after expiration of current BNSF-Tex Mex agreements.”⁶

KCS’ diversion analysis confirms KCS’ intent to divert traffic from BNSF, even if that diversion results in inefficient routings of rail traffic. The only way that KCS could achieve such inefficient diversions would be to impose restrictions on BNSF that prevent it from remaining an effective competitor for the traffic. KCS anticipates that its control over Tex Mex alone – without considering the future impact of KCS’ control over TFM – will result in the diversion of 4,725 rail cars from BNSF to KCS, which represents almost 10% of BNSF’s traffic through Brownsville and Laredo. *Rickershauser V.S.* at 16. Two-thirds of that traffic will be diverted from a BNSF interchange with Tex Mex at Robstown or Corpus Christi to an interchange with KCSR at Kansas City, and in most cases, the new diverted route is longer than the existing BNSF-Tex Mex route. KCS provides no analysis of which shippers are presumed to choose this new route or on what basis KCS assumed that the traffic would divert to KCS.

Similarly, KCS indicates that it will divert 10% of BNSF’s traffic from Brownsville to Laredo, even though the vast majority of that traffic is destined to points just across

⁶ Supplement to the Kansas City Southern Railway Company’s and the Texas Mexican Railway Company’s Responses and Objections to Union Pacific Railroad Company’s Third Set of Discovery Requests to Applicants, Supplemental Responses, served July 23, 2003, Request No. 26, at p. 2.

the border at Brownsville. Presumably, KCS intends to reroute the traffic through Laredo, south over TFM to Monterrey, and then back north to the border town of Matamoros, Mexico. It is highly unlikely that such inefficient re-routings would result from customer preference, and the only inference must be that KCS intends to impose that rerouting based on discriminatory pricing and service to BNSF.

III. KCS' TRAFFIC DIVERSIONS COULD DRIVE SHIPPERS TO USE LESS EFFICIENT ALTERNATIVE ROUTINGS AND THEREBY REDUCE OVERALL RAIL COMPETITION

Unless properly conditioned, the proposed transaction threatens to injure shippers in two ways. First, because the combined NAFTA Rail will have the ability and incentive to divert traffic to its routes in the U.S., and because of inefficiencies in many of those routes, shippers may be forced to use longer, slower, less efficient service for rail transportation through Laredo and Brownsville. Second, to the extent that NAFTA Rail succeeds in diverting traffic from BNSF and reduces BNSF's long-term competitiveness through Laredo and Brownsville, the transaction may lessen the competitive options open to many shippers who ship goods through those gateways. Such a lessening of competitive options threatens to undo the benefits that resulted from the Board's conditions imposed on the UP/SP merger.

KCS' potential traffic diversions may injure shippers by forcing them to use less efficient alternatives to reach Mexico. As discussed in the Verified Statement of Mr. Rickershauser, the KCS-Tex Mex route to Laredo is less direct than the BNSF-Tex Mex route for at least two reasons. First, "Tex Mex's trackage rights between Houston and Robstown require trains to travel 286 miles. Rather than following the coastline as BNSF's trackage rights do, Tex Mex must travel due west to Flatonia from Houston, before heading south to Robstown through Placedo." Rickershauser V.S. at 12. This

diversion is 23% longer than BNSF's route between Houston and Robstown. *Id.* Second, due to BNSF's diversity of routing options, BNSF offers a more direct route to Laredo from most major interline junction points across the U.S. In fact, KCS' routes from major cities to Laredo are anywhere from 3% to 44% longer than the comparable route for BNSF. See Mileage Comparison Chart attached as Exhibit 2 to Mr. Rickershauser's Verified Statement.

Of course, in the delivery of most products, "time is money, and slower service is a significant disadvantage" to shippers. See Letter from Louis R. Mastandrea, Unimin Corporation, to Secretary Williams, dated July 23, 2003 ("Mastandrea Letter") at 2. As shippers have made clear in their submissions to the Board, one of their "primary concerns in transporting . . . products to Mexico is transit time." Letter from Gary Kidwell, AK Steel Corporation, to Secretary Williams, dated July 25, 2003 ("Kidwell Letter") at 2.⁷ The delays imposed by forced diversions to KCS' lines would likely make KCS' service uncompetitive for much traffic going to Mexico, particularly grain, motor vehicle and auto parts, and intermodal traffic, which collectively account for almost half of BNSF's traffic. *Rickershauser V.S.* at 5-7.

The forced diversion of traffic to KCS would further injure shippers because KCS cannot offer the range of services that BNSF can offer. While "BNSF moves over 3

⁷ Mr. Kidwell further explained: "AK Steel is concerned that once the formation of the NAFTA Railway is completed, TFM will favor traffic that originates on its affiliated companies, i.e., KCS and TexMex, over interchange traffic received from UP or The Burlington Northern & Santa Fe Railway Company ("BNSF"). If such discriminatory practices occur, there would be a detrimental impact on cycle times, which in turn would greatly impact AK Steel's ability to obtain reliable and efficient transportation service into Mexico." Kidwell Letter at 2.

million intermodal shipments per year, KCS moves comparatively few.” Rickershauser V.S. at 13. KCS’ smaller scale results in less equipment availability, which limits KCS’ ability to offer credible competitive service to large shippers. *Id.* Further, with only 3,130 route miles of track, KCS is not able to offer the geographic scope of service that BNSF can offer given its 33,000 route miles. This further limits KCS’ ability to offer credible service to shippers seeking a comprehensive, single-source provider of rail transportation.

Since the Board’s decision in the UP/SP merger granting BNSF trackage rights over UP, BNSF has achieved a toehold as an effective competitor to UP for Mexico traffic. As stated earlier, becoming an effective competitor in the Texas/Mexico corridor through Laredo has required substantial investment on the part of BNSF – over \$20 million in marketing alone. It has also required BNSF to aggressively work with Tex Mex and TFM to create value-added services like Mexi-Modal and to improve overall efficiency by blocking of northbound rail traffic and other efficiency improvements. This transaction could threaten to undo BNSF’s hard work, reducing the competitive options to shippers.⁸

⁸ For example, NAFTA Rail’s projected traffic diversion threatens to reduce by almost 20% the traffic gains made by BNSF in the six years since the Board’s UP/SP decision. That reduction in traffic density “would squeeze BNSF’s margins and could force BNSF over time to rationalize the frequency of the train service that it offers.” Rickershauser V.S. at 14. Over the long run, faced with competitor control over both Tex Mex and TFM, potentially unable to offer value-added services or to negotiate efficiency-enhancing cooperative agreements, and faced with potentially discriminatory rate-setting for traffic to Mexico, BNSF may be forced to reduce its overall marketing expenditures and customer-driven infrastructure improvements for traffic over the Laredo and Brownsville gateways. *Id.* Such a reduction in service would clearly adversely affect shippers.

KCS will not be able to replace BNSF as the primary competitive alternative to UP. Contrary to assertions recently made by KCS, the Board envisioned BNSF serving as the principal competitive replacement to UP through Laredo. Decision No. 44 at 422. Over the past six years, BNSF *has been* the primary competitive alternative to UP for good reason. First, KCS' routes are longer even than BNSF's routes from most points. Given the difficulty BNSF has competing with UP's more direct routes, KCS would be at an even greater disadvantage. Second, KCS does not offer the same geographic scope of single-line service that BNSF or UP can offer, making KCS less attractive to shippers with multiple origination points. *Rickershauser V.S.* at 13-14; *Reishus V.S.* at 12.

Contrary to the assertions of some, other Mexican gateways do not offer a competitive alternative to Laredo and would not be able to ensure competitive discipline on UP if the transaction undermined BNSF's competitiveness at Laredo. First, none of the other gateways (Brownsville, El Paso or Eagle Pass) has the physical infrastructure that is in place at Laredo, and, as a result, dramatically increased shipper volumes moving through these international gateways would strain existing capacity, resulting in delays for existing as well as rerouted traffic. Second, El Paso and Eagle Pass are out of route for most eastern shippers who ship through Laredo, adding further inefficiency at those gateways. Third, because El Paso and Eagle Pass gateways provide interchange with Ferrocarril Mexicano, S.A. de C.V. ("FXE") rather than TFM, any shipment through those gateways for destinations served by TFM would require an extra interchange within Mexico at best, if such a routing would be feasible or available. Moreover, because "in practice, FXE cannot serve most shippers and receivers on

TFM's line," those gateways are ineffective as alternatives to Laredo. See *Rickershauser V.S.* at 18.⁹ Finally, besides the fact that BNSF's only connection into Mexico at Brownsville would be over the KCS-controlled TFM, Brownsville cannot serve as a replacement to Laredo because the infrastructure of the track between Matamoros and the TFM main line cannot accommodate the traffic that moves through Laredo, and because that route is longer and slower than a comparable shipment through Laredo for most TFM points. *Id.*¹⁰

⁹ Mr. Rickershauser's conclusion is confirmed by Mr. Mastandrea's July 23, 2003 letter to Secretary Williams. There, he notes that a routing via FXE over Eagle Pass has several "significant disadvantages".

First, it is more circuitous, which means that shipments will take longer and cost more. Second, shipments from the United States move much more quickly through Laredo than through Eagle Pass (or Brownsville, for that matter) because there has been much more investment at Laredo. In this business, time is money, and slower service is a significant disadvantage. Similarly, because ball clay moves in carloads instead of unit trains, the less frequent service on the Eagle Pass-FXE route is also a disadvantage. Since the Eagle Pass-FXE route is used much less intensively than the Laredo Bridge, it takes longer on the FXE routing to assemble a trainload of empty cars to return from Mexico to the United States, thus further slowing the cycle time and increasing costs.

Mastandrea Letter at 2-3.

¹⁰ Truck and water competition also cannot serve as an effective replacement for open rail gateways. Although KCS suggests in its control application (at 27-28) that truck competition obviates the need for conditions, KCS' witness Curtis Grimm took the opposite position in his testimony on behalf of Tex Mex when Tex Mex was seeking trackage rights conditions over UP in 1996. See Verified Statement of Curtis M. Grimm, filed March 29, 1996, in Finance Docket No. 32760 (Sub-No. 13) (excerpted at Exhibit 2 to *Reishus V.S.*). There, he stressed that "[a]lthough truck and water play an important role overall in transportation of goods between U.S. and Mexico, many shippers of many commodities are dependant upon rail competition for competitive transportation (cont'd)

IV. IMPOSITION OF AN OPEN GATEWAY CONDITION IS AN APPROPRIATE REMEDY TO BE IMPOSED BOTH AT ROBSTOWN AND AT BROWNSVILLE AND LAREDO

A. An Open Gateway Condition Is Consistent With The Board's Decision In Ex Parte No. 582 (Sub-No. 1) As Well As KCS' Position In That Proceeding

In Ex Parte No. 582 (Sub-No. 1), the Board recognized that existing major gateways should be kept open in future mergers and that such gateways need to be open both physically and economically. As part of its rationale for so holding, the Board recognized that most inefficient gateways have either been closed or move only minimal traffic, and it noted the broad support expressed for preserving major existing gateways. June 11 Decision at 25-26. Accordingly, the Board stated that it would "require applicants to present an effective plan to keep open major existing gateways" and would "impose conditions on any transaction that [it approves] to ensure that result." *Id.*

Moreover, an open gateway condition is consistent with the position that KCS took in the Ex Parte No. 582 (Sub-No. 1) proceeding, where it insisted that all existing competitive shipper rail options should be preserved in future merger or control

(... cont'd)

options." *Id.* at 128-29. The United States Department of Agriculture ("USDA") has suggested here that grain and grain products may be uniquely susceptible to truck and water competition, see USDA Comments filed July 25, 2003, but Dr. Grimm in 1996 pointed to the USDA's own reports to demonstrate the ineffectiveness of truck and water alternatives as substitutes for long-haul rail transportation. *Reishus V.S.* at 15, n.20. Indeed, if the Board had believed that truck and water competition could act as effective replacements for rail competition through Laredo and Brownsville, there would have been no need for it to condition its approval of the UP/SP transaction on access for both BNSF and KCS to Laredo and for BNSF to Brownsville.

transactions.¹¹ Particularly given that the Board has already acknowledged that the proposed merger between KCS and TFM would fall under the new merger rules but for the fact that TFM is across the Mexican border, application of the open gateway principle is appropriate here as well.

B. An Open Gateway Condition Is Consistent With Conditions Imposed In Other Control Proceedings

In addition to being a part of the new merger process applicable to Class I railroad mergers, the imposition of open gateway requirements has become the norm in rail control transactions to which the new regulations have not applied. In the CN/IC transaction¹² (which preceded the new rules), the Board imposed a condition requiring that the merging parties keep the Chicago gateway between CP and IC open and competitive. This condition was imposed despite the recognition of CN/IC's stated economic incentive and intent to keep that gateway open and competitive.

Similarly, in a 2001 control transaction between a Class I railroad, Canadian National, and a Class II railroad, Wisconsin Central, the Board imposed conditions to "keep all existing active gateways affected by the Transaction open on commercially reasonable terms."¹³ The CN/WC transaction, like the one at issue here, was classified

¹¹ See "Seven Modest Adjustments Toward Better Balance in Rail Mergers", KCS (Aug. 3, 2000) at 5 ("the Board's guiding principle in any future merger proceeding should be to preserve rail service options available to shippers."). See also KCSR ANPR Comments at 14 ("it should be the policy of this Board to preserve the few remaining competitive rail options").

¹² *Canadian National Railway Co. – Control – Illinois Central Corp.*, Finance Docket No. 33556.

¹³ *Canadian National Ry. Co. – Control – Wisconsin Central Transp. Corp.*, Finance Docket No. 34000, Decision No. 10 (served September 7, 2001), at 28.

as a “minor transaction”. As a mechanism to fulfill the open gateway requirement, CN/WC entered into an agreement with NIT League that required the establishment and maintenance of commercially reasonable contract through rates on all its active gateways; that restricted any increase in their portion of common carrier through rates for five years to a measure of RCAF-U; and that precluded the closure of any active interchange after the five-year period by any commercially unreasonable means.

As Dr. Reishus explains in his Verified Statement, these modern gateway commitments are easily distinguished from the anticompetitive and discredited “DT&I conditions” that the Interstate Commerce Commission routinely imposed in the past.¹⁴

Dr. Reishus explains:

The DT&I conditions, which rigidly froze in place rates and interchanges as part of merger approval, were imposed on an overly regulated rail industry in desperate need of network rationalization and effectively required that rates be frozen indefinitely over routes and interchanges, no matter how circuitous, insignificant, or inefficient. The DT&I conditions functioned as an anticompetitive barrier to necessary rationalization of the rail industry. By contrast, the current gateway requirements are focused on specific significant gateways, impose specific rate caps for only limited terms (five years) subject to cost-related increases, and require only that the gateway be open on commercially reasonable terms thereafter. The commitments do not preclude procompetitive rate reductions in response to changing marketplace conditions. Rather, these gateway requirements provide a competitive transition for shippers in the face of the loss of a neutral connection and provide a regulatory backstop to actions of the newly merged parties.

Reishus V.S. at 21.

¹⁴ *Detroit, Toledo & Ironton R.R. Co. Control*, 275 I.C.C. 455, 492-93 (1950).

C. An Open Gateway Condition Is Necessary To Preserve BNSF's Ability To Offer Effective SP Replacement Competition

At the time of the UP/SP decision, Tex Mex was an independent rail carrier, with barely enough traffic to sustain its own business. "Because of the UP/SP merger agreements and conditions, Tex Mex became a neutral, independent bridge carrier capable of interlining with both BNSF and KCSR in competition with UP for traffic to and from the Laredo gateway." *Reishus V.S.* at 10. There was no reason to believe that Tex Mex might have an incentive to artificially discriminate between its rail connections. Further, the Mexican railroad network was operated by the Mexican government, and, although privatization was on the horizon, "[i]t was anticipated . . . that the resulting privatized Mexican rail companies would provide neutral, competitive access to shippers in Mexico and for international traffic from the U.S." *Reishus V.S.* at 17. In fact, the past and current TFM management practice has been one of neutrality generally over the Laredo gateway for U.S. carriers, unless one carrier offered a specific and differentiated market product not provided by the other U.S. carriers which provided benefits to TFM and TFM customers meriting differential treatment. Examples of this neutral, pro-competitive behavior by TFM include:

- TFM has entered into partnerships with all three connecting railroads, UP, BNSF, and KCS, to offer intermodal service between the U.S., Canada and Mexico;
- TFM has collaborated with BNSF (and Tex Mex) to improve service to Mexico, for example, by increasing the efficiency of unit grain trains and by improving through train efficiency;
- TFM has built and subsequently upgraded key facilities to improve the handling of U.S.-Mexico traffic, such as the Sanchez yard at Nuevo Laredo, which benefits all U.S. railroads serving U.S. Mexico traffic.

Reishus V.S. at 18.

With KCS' control over Tex Mex and TFM, this state of neutrality could well change. Because BNSF's ability to compete with UP for Mexico traffic depends on offering its customers door-to-door transportation packages – including competitive rates, service, equipment quality and information exchange – any negative change to Tex Mex's and TFM's neutral stance condition could reduce BNSF's ability to serve as an effective competitor. It bears emphasizing that BNSF's ability to meet customer needs depends on competitive rate and service offerings from both Tex Mex and TFM. UP already has a well-established route to Laredo, with considerable mileage advantage compared to BNSF's route, so BNSF's ability to compete is driven by providing value-added solution services. If Tex Mex and/or TFM are no longer neutral, and do not cooperate in providing value-added services, BNSF's ability to meet its customers' needs and compete with UP will be substantially diminished. *Rickershauser V.S.* at 16.

Mr. Kidwell of AK Steel expressed this concern in his letter to Secretary Williams.

In addition, AK Steel is concerned that the formation of the NAFTA Railway could impact on the ability of competing carriers to provide service to Mexico on commercially reasonable terms. As noted above, AK Steel currently has a variety of alternative transportation routings that it can use to transport its products to Mexico. The combination of KCS/TexMex/TFM, however, presents an incentive for TFM to favor KCS/TexMex to the detriment of other carriers, like UP and BNSF, that connect with TFM at the Laredo Bridge. In so doing, TFM can exercise bottleneck control to assure that AK Steel's only transportation options will be those involving the NAFTA Railway. Such practices would greatly limit UP's and BNSF's ability to provide competitively priced service for AK Steel's transportation needs to the Mexican gateway.

Kidwell Letter at 2. See *also* Letter from Jose Robles, Kimberly-Clarke de México, S.A. de C.V., to Secretary Williams, dated July 8, 2003 (the Board should ensure “that NAFTA Rail is prevented to discriminate [sic] against shipments delivered to Laredo by other carriers on both sides of the border”); Letter from Edwin E. Vigneaux, Reagent Chemical & Research, Inc., to Secretary Williams dated July 10, 2003, at 1 (“We believe the only way to achieve [open competition at the Laredo Gateway] is for the NAFTA carriers to keep this gateway open on commercially reasonable terms.”).

KCS is not an adequate replacement for BNSF and could not replicate the competition that SP provided to UP before that merger. KCS’ network size and scope do not match SP’s scope before the merger, and certainly do not match the size and scope of BNSF’s network or UP/SP’s network after the merger. BNSF’s network, on the other hand, closely matches UP’s in territorial coverage and connections and is the only network even close to matching UP/SP in combined origin/destination territories. KCS’ network is particularly deficient in comparison to BNSF’s connectivity to railroads in the eastern and northern United States and Canada. *Rickershauser V.S.* at 19.

D. An Open Gateway Condition Should Provide For A Transition Period Which Continues Existing Rates

In imposing an open gateway condition on the KCS/Tex Mex transaction, the Board should provide a transition mechanism to ensure that there are no significant market dislocations during the implementation period. Such a transitional time period would permit the development of effective interline routing and commercial relationships in light of the transaction. As Dr. Reishus states in his Verified Statement:

Application of open gateway conditions on the Laredo and Brownsville gateways that limits increases in rates over a fixed period, such as five years, is a reasonable public policy accommodation to preserve competition and shipper

options. The interchanges . . . are obviously major, efficient interchanges that experience growing traffic levels; there is no risk that inefficient routings will be preserved in the foreseeable future. As recent merger proceedings prior to this one show, these rate and service restrictions have been offered, negotiated, or imposed by or on the merging parties in a manner that has been acceptable to the parties. These restrictions do not appear to have diminished the efficiency gains that the mergers generate nor do they appear to have deterred the merging parties from completing their transactions and capturing these gains. The Applicants have provided no evidence of any harm that would result from the preservation of existing competitive conditions for a limited period of time that would outweigh the protection that they provide to competition and shippers.

Reishus V.S. at 26-27.

E. The Board Has Jurisdiction to Impose Open Gateway Conditions At Laredo And Brownsville For Cross-Border Traffic

Although KCS agreed at the Board's July 31st hearing to the imposition of open gateway conditions at Laredo and Brownsville, it previously suggested in the Supplement to Application, filed June 23, 2003, that the Board would have no jurisdiction to impose conditions that would implicate its plan to acquire control of TFM. KCS Supplement at 3 n.2. Because open gateway conditions at Laredo and Brownsville would necessarily implicate KCS' plan to acquire control of TFM – indeed, open gateway conditions are required at Laredo and Brownsville precisely because of KCS' plan to acquire control of TFM – KCS' jurisdictional objection to such conditions may now be moot. Nevertheless, to avoid any doubt regarding the Board's authority to impose such conditions, a brief review of the legal basis for that authority is set forth below.

First, no one disputes that the Board has jurisdiction over KCS and Tex Mex or that the Board can impose conditions in the U.S. public interest on KCS' acquisition of

control of Tex Mex. See 49 U.S.C. § 11324(c); 49 C.F.R. § 1180.1(d). Furthermore, there is no doubt that the Board's jurisdiction extends not only to domestic rail traffic but also to traffic moving between the U.S. and a foreign country. See 49 U.S.C. § 10501(a)(2)(F). In fact, it was specifically because of the Board's concern that competition be maintained for cross-border traffic moving between the U.S. and Mexico through Laredo and Brownsville that the Board in the UP/SP proceeding conditioned that transaction on BNSF's obtaining access to Laredo and Brownsville to act as a competitive counterweight to UP for that traffic. KCS too owes its access to Laredo to the conditions imposed by the Board in that proceeding to maximize competition for U.S.-Mexican traffic.

Second, KCS' plans to acquire control of TFM and integrate it into NAFTA Rail are closely related to its acquisition of control of Tex Mex. This is not a situation, like KCS' acquisition of the Panama Canal Railway Company, where there is no connection between the transaction before the Board and a transaction in another country. KCS' planned TFM acquisition is part and parcel of KCS' NAFTA Rail plan. Most of the traffic that moves over Tex Mex today is bridge traffic that is terminated or originated by TFM. KCS has made clear that it expects to use its integrated NAFTA Rail system to divert traffic that currently moves via BNSF-Tex Mex-TFM or UP-TFM through Laredo and BNSF-TFM or UP-TFM through Brownsville to KCS-Tex Mex-TFM routings. Whether those diversions occur because KCS' integrated system offers better service and rates or because KCS uses its control of Tex Mex and TFM to foreclose BNSF and/or UP depends on whether the Laredo and Brownsville gateways truly remain open, both physically and economically. Arguably, how KCS uses its control of TFM is even more

important than how it uses its control of Tex Mex, because TFM is the only carrier carrying traffic to and from Mexico from both Laredo and Brownville.

The STB need not be concerned that it is being asked to “regulate” in a foreign country. The issue here is not intra-Mexican traffic. The issue here is cross-border traffic moving between the U.S. and Mexico – in which the U.S., its shippers, and its railroads have a vital interest. The Board made clear in Ex Parte No. 582 (Sub-No. 1) that the public interest is served when major gateways remain open in the wake of a merger, and this includes major international gateways. June 11 Decision at 25-26. While Mexican or Canadian law may also have a role to play in keeping those gateways open, the Board must make its own judgment about the conditions that are appropriate to protect U.S. commerce when railroads seeking approval for transactions involves cross-border traffic. *Reishus V.S.* at 22-25. In fact, in UP/SP, the Board emphatically rejected the suggestion from KCS that cross-border traffic with Mexico involved foreign policy considerations that were beyond the Board’s jurisdiction: “We reject KCS’ various challenges to our jurisdiction and to the manner in which this proceeding has been conducted. Our jurisdiction extends to rail traffic moving in foreign commerce.” Decision No. 44 at 464.

More recently, in Ex Parte No. 582 (Sub-No. 1), the Board rejected arguments that it could not require the submission of information from merger applicants regarding the impact of their foreign operations on U.S. commerce. June 11 Decision at 46-47. In fact, the Board specified in its new merger rules:

All applicants must submit “full system” competitive analyses and operating plans – incorporating any operations in Canada or Mexico – from which we can determine the competitive, service, employee, safety, and environmental

impacts of the prospective operations within the United States [49 C.F.R. § 1180.1(k)]

Thus, there is no doubt that an applicant before the Board can be required to make known its plans for cross-border operations and that the Board can condition the proposed transaction and any affiliated transactions so as to protect U.S. interests.

Third, the Board has jurisdiction to protect its own conditions. In UP/SP, in order to protect U.S. interests in cross-border traffic, the Board imposed as a condition on the transaction that BNSF be given access to Brownville and, via Tex Mex, to Laredo. It also gave KCS access via Tex Mex to Laredo. At the time, both TFM and Tex Mex were independent carriers and could be expected to set reasonably competitive rates in connection with BNSF. There was no apparent need to impose open gateway conditions. Even so, after BNSF had negotiated an agreement with Tex Mex in 1998, it was stymied for some time in obtaining a final agreement. Because of the Board's continuing oversight of the UP/SP transaction, BNSF had an avenue for relief from the Board. If KCS obtains control of both Tex Mex and TFM, it will be in a position potentially to interfere with BNSF's ability to continue to provide efficient cross-border service via Laredo and Brownsville. BNSF would certainly hope to avoid any need to approach the Board to resolve any dispute about gateway closure which became intractable, but if a proceeding became necessary, there can be no doubt that the Board would have jurisdiction to enforce the conditions it imposed in UP/SP and require KCS to permit its controlled affiliates to continue commercially reasonable rates and practices with BNSF.

Finally, it bears emphasizing that the Board's authorization of a control transaction is permissive. If the parties seeking that authorization do not wish to comply

with the conditions that the Board sets in the public interest, they need not consummate the transaction. Thus, if KCS did not expect an open gateway condition to be imposed at Laredo or Brownsville and did not wish to comply with such a condition, it would not have to proceed with its acquisition of control of Tex Mex. In this case, of course, KCS has confirmed that it anticipated such a condition and has already agreed to its imposition. Even were it not estopped from challenging the Board's jurisdiction, however, it could not reasonably complain that it should not be required to comply with open gateway conditions as a prerequisite to the consummation of its NAFTA Rail plans.

CONCLUSION

For the reasons set forth above, BNSF respectfully submits that, should the Board find that the proposed KCS/Tex Mex control transaction is in the public interest and determine to approve the transaction, then it should condition its approval of the transaction by requiring the Applicants to maintain the existing Tex Mex and TFM rates and services presently available for service in conjunction with BNSF for a temporary five-year period, subject to RCAF-U increases, and to provide commercially reasonable rates and services thereafter subject to the jurisdiction of the Board. The imposition of such a condition to maintain open gateways at Robstown, Laredo and Brownsville on a "commercially reasonable" basis would provide shippers and connecting carriers a safety net and regulatory jurisdictional backstop if the market did not function to preserve and permit the use of efficient routings in the future if and when problems

developed. It would do so without unduly affecting the Applicants' ability to offer shippers the benefits of the proposed transaction.

Respectfully submitted,



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Dated: August 4, 2003

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served on all parties of record in Finance Docket No. 34342 by first-class mail or a more expeditious manner.

Brian J. Gell.

**VERIFIED STATEMENT
OF
PETER J. RICKERSHAUSER**

My name is Peter J. Rickershauser. I am the Vice President of Network Development for The Burlington Northern and Santa Fe Railway Company (“BNSF”). My business address is 2650 Lou Menk Drive, Fort Worth, TX 76131.

The purpose of this Verified Statement is to set forth BNSF’s position on the control transaction proposed by KCS and Tex Mex. BNSF wants to support KCS in its NAFTA Rail transaction. BNSF’s interest in the transaction and the overall KCS/Tex Mex/NAFTA Rail transaction is to ensure that rail shippers throughout the United States, Canada and Mexico who rely on BNSF to provide them access to south Texas and Mexico markets and customers are not competitively worse off as a result of the tandem NAFTA Rail transactions. The pledges and other commitments which KCS has made to the Board address many of BNSF’s concerns, and, as a result, BNSF supports the proposed transactions subject to the acceptable clarification of KCS’ pledges and to their inclusion as conditions on the Board’s approval of the transaction in this proceeding.

BNSF believes that, in reviewing the transaction, the Board should address the unique aspects of the transaction by ensuring that KCS, Tex Mex, and TFM maintain open gateways through Laredo and Brownsville and by requiring specificity to KCS’ pledges that “it will keep the Laredo gateway open on commercially reasonable terms,” that KCS will “continue to cooperate with UP, [and] BNSF . . . on interline services,” that “KCS [will] honor the terms of all marketing and pricing agreements involving Tex Mex and TFM . . . to their full term and will not seek to cancel them early,” that “[a]ll carriers will be treated fairly at the Laredo bridge,” and that “[t]here will not be significant changes in operations and safety will remain a top priority.”

Verified Statement of Gerald Davies, Supplement To Application, filed June 23, 2003 (“Davies V.S.”), at 14-17.

BNSF is in the unique position of having, unlike UP, to rely on Tex Mex interchange service over Corpus Christi and Robstown, TX to reach the Laredo gateway, thus involving two additional significant interchange points for rail customers in south Texas as well as Mexico to be considered in any discussions involving gateways. BNSF understands KCS’ plans to use the NAFTA Rail system to “help secure the financial stability of Tex Mex,” bring investment to the Tex Mex system, and generally improve operations and capacity across the Tex Mex network which BNSF and our customers rely on for south Texas and Laredo access. But, while the Applicants have pledged to “keep the Laredo Gateway open on commercially reasonable terms,” *Id.* at 15, they have not given the type of detailed, written assurances that are needed to ensure the shipping public that the Applicants will provide commercially reasonable rates to BNSF between Laredo and Robstown, and that the new NAFTA Rail will provide competitive rates and service for BNSF traffic moving via Laredo and Brownsville to and from customers and points accessed by TFM in Mexico. Such commitments are needed in this case to ensure that shippers relying on BNSF to access markets in south Texas served by Tex Mex and Mexico served by TFM are not injured and to ensure that BNSF can continue to serve as an effective competitive replacement for SP vis-à-vis UP, as envisioned under the UP/SP merger conditions.

BACKGROUND AND QUALIFICATIONS

I joined BNSF in October 1996, as Vice President, Marketing, UP/SP Lines. Subsequently, I served as Vice President, Marketing for the UP/SP Lines and the Mexico Business Unit. In those positions, I was responsible for, among other things, coordinating the marketing and implementing of the new service opportunities that BNSF offers to shippers as a

result of the merger of UP and SP, and for coordinating the marketing and service offer for BNSF's Mexico service. Because of my experience in those positions, I am intimately familiar with the market and competitive conditions affecting rail transportation in southern Texas and Mexico.

Prior to joining BNSF, I was Vice President, Sales, with SP in Denver, Colorado, where I directed SP's field carload sales force in the United States and Canada. From 1991 to 1995, I was Managing Director, Regional Sales-Midwest, in Lisle, Illinois, for SP. Prior to that, I spent nine years in various sales and marketing management positions with Norfolk Southern Corporation, seven years in various sales management positions with Norfolk & Western Railway Company, and three years in track maintenance and transportation assignments with several predecessors of Conrail. As a result of my extensive sales, marketing, and transportation experience, I have gained detailed knowledge of the needs of customers and how railroads can meet those needs.

In my current position as Vice President of Network Development, I focus on developing BNSF's rail network to better meet the needs of BNSF's shipper customers. In this capacity, I have acquired substantial knowledge of the strengths and weaknesses of BNSF's rail network and of the networks of our connecting carriers and competitors.

I. BNSF'S COMPETITIVE SERVICE OFFERING IN SOUTHERN TEXAS AND MEXICO

Since the Board's decision in the UP/SP merger proceeding granting BNSF trackage and haulage rights to reach Mexican markets via border crossings points including those in Brownsville and Laredo, TX, effective in September, 1996, BNSF has worked aggressively to expand our Mexican commercial presence on both sides of the international border and to develop an effective competitive offering for customers' traffic bound to or from Mexico

through the Laredo and Brownsville, as well as other gateways. In the past six years, BNSF has invested over \$20 million marketing BNSF's service to and from Mexico. Since 1996, BNSF has:

- Increased its annual marketing expenditures for Mexican traffic by over 1000%;
- Identified over 2,000 Mexican rail customers for which BNSF can provide connecting international rail transportation;
- Added 7-10 additional trains each way per week over the BNSF-Tex Mex line compared to what BNSF previously routed via SP-Tex Mex;
- Developed value-added services, such as Mexi-Modal (a door-to-door intermodal service including CN and CSX railroads) and Mexi-Rail (an integrated dock-to-dock carload service);
- Developed efficient unit grain train services in partnership with TFM by focusing on total cycle times for rail cars;
- Helped Mexican customers finance and build track expansions at their facilities on TFM to encourage business to shift to rail;
- Partnered with Tex Mex and TFM to improve through train efficiency by managing the "Despacho Previo" (border customs clearance) process, as well as participating in train pre-blocking to reduce handlings northbound and southbound on BNSF, Tex Mex and TFM;
- In coordination with other carriers and service providers, developed the ability to deliver "one-stop shop" products and services.

Through BNSF's aggressive marketing, its increased service, and its value-added offerings, BNSF increased its Laredo traffic by 87% from 1996 to 2002, making it, as validated by KCS in its control application (at 77), "Tex Mex's primary interchange partner, with 35,000 carloads of forwarded and 10,000 cars of received traffic in 2001." In 2002, BNSF carried almost 40,000 cars of traffic to and from the Laredo gateway. *See Exhibit 3.* BNSF has also increased traffic over its Brownsville route by 250% over the 1996-2002 time period, with over 10,000 cars exchanged at the Brownsville gateway in 2002. This competition by BNSF has

imposed a competitive discipline on UP, which is reflected by the fact that UP's average rate over Laredo did not increase at all during the period 1997 to 2001. UP Fifth Annual Oversight Report in F.D. No. 32760 (Sub-No. 21) (UP/SP 384) (July 2, 2001) ("2001 Oversight Report"), at 111.

The significance for rail freight transportation service providers to reach and maintain access to the Laredo gateway for NAFTA flows cannot be understated. For 2001, fully 75% of all rail shipments between the U.S. and Canada to and from Mexico passed through the Laredo gateway over either UP or Tex Mex. As KCS stated in its control application, "Laredo has long been the principal rail gateway between the U.S. and Mexico. This fact is due to Laredo's superior infrastructure, such as customs brokers, and its location on the shortest route between many U.S. and Mexican origins and destinations, particularly between major Mexican industrial and population centers and the Midwest and Eastern U.S." Application, filed May 13, 2003 at 84.

As detailed in Exhibit 1, BNSF's traffic through Laredo and Brownsville is primarily in four commodity categories of traffic: agricultural goods, industrial materials, motor vehicles and auto parts, and intermodal traffic. A brief description of that traffic follows.

Agricultural Products. Over a third of BNSF's Laredo traffic is grain traffic and over 80% of BNSF's Brownsville traffic consists of grain and grain products, much of which is consumed by customers in Matamoros, directly adjacent to Brownsville. Because grain is a commodity product, customers are particularly sensitive to changes in shipping costs. BNSF's customers include both grain suppliers in the U.S. that need the least-cost/highest service/most efficient route for distributing their grain, and Mexican grain purchasers that need access to a broad number of U.S. grain suppliers to ensure competitive grain delivery economics.

Competition for this business includes other railroad combinations, other commodities and geographic areas, and, to an extent, other transportation modes, including water-borne and truck. BNSF has addressed competitive issues in a number of ways, including extending our high service and efficient 110 car grain shuttle network in partnership with Tex Mex and Mexican rail carriers to a growing number of new and expanded shuttle facilities within Mexico. Because of BNSF's efficient routes, extensive interline connections, added services, and broad geographic reach in grain production areas across the western United States, BNSF has been able to increase its agricultural traffic to Mexico via Laredo by 258% since 1996.

Industrial Products. Traffic in industrial products carried to and from the Laredo gateway by BNSF has grown 154% since 1996, and this traffic now constitutes over a third of BNSF's Laredo traffic. This traffic consists of a variety of different products from scrap paper and cement to aluminum and steel products. Shippers of these goods, and other products such as chemicals, are often either small or operating at widely-dispersed locations, and buyers will often seek to single-source contract with rail carriers that can give them broad access to those shippers. BNSF's broad western U.S. geographic reach and connections to carriers servicing other areas in the eastern U.S. and Canada has allowed it to compete effectively for those customers' business and thus increase its traffic.

Motor Vehicle and Auto Parts. BNSF's motor vehicle and auto parts traffic constitutes 13% of its Laredo traffic, with over 5100 cars shipped annually. Although BNSF has been more successful in serving this traffic via its western Mexican gateways (due to the location of traditional BNSF auto partners' manufacturing locations on the rail networks within Mexico), its ability to provide competitive pricing at the Laredo gateway and its ability to provide reliable and timely service have nonetheless imposed competitive discipline on UP. For example, as a

result of BNSF's competition with UP, UP reduced its overall cost of service to DaimlerChrysler by 25-30% for traffic between the U.S. and Mexico. Consequently, while BNSF's overall share of automotive traffic to and from Mexico is small, our ability to continue to compete (and hopefully secure) more of that traffic in the future depends on the interline service offerings and cost parameters BNSF receives from NAFTA Rail to move via Tex Mex and TFM.

Intermodal. BNSF has invested heavily to attract intermodal traffic to BNSF's network. While intermodal traffic constituted only 8% of BNSF's traffic through Laredo in 2002, that traffic has increased 156% since inception in 1997, and BNSF expects the traffic to continue to grow at double digit rates over the next three years. Intermodal shippers are some of the most time-sensitive customers for BNSF because they carry both inputs to manufacturing, as well as finished goods to distributors for ultimate consumers. BNSF has grown this business in part through the development of its Mexi-Modal service, which is a unique product offering of door-to-door service between the U.S., Canada and Mexico. In addition, BNSF has worked with Tex Mex in developing joint intermodal services in conjunction with Tex Mex's new intermodal facility at Serrano Yard (Milepost 9) on Tex Mex directly east of Laredo. BNSF also worked with Tex Mex and TFM to develop coordinated in-bond U.S. and Canadian products for service to and from points within Mexico. Indeed, without accessing and exploiting BNSF's extensive intermodal network on an interline basis, Tex Mex has a geographically-constricted intermodal service offering for shippers and receivers at Laredo with which to compete with UP's nearby extensive Port Laredo facility, leaving most of the western U.S. without alternative competitive intermodal product offerings.

NAFTA Traffic. In addition to its service to U.S. shippers, BNSF also carries significant NAFTA traffic via its connections with Canadian carriers. BNSF's direct north-south routing

and extensive connections with both CP and CN make BNSF an attractive shipping partner for Canadian traffic, a significant portion of which moves to or from Mexico. For example, in 2002, BNSF carried over 6,800 rail cars from Canada to Mexico, which alone equals almost a quarter of *all* traffic carried by KCS over Tex Mex.

A major operational and marketing initiative being undertaken by BNSF and our partner connecting carriers calls for redesigning interline flows to focus interline carload traffic over fewer gateways with improved service consistency and shipment velocity. A key component of these initiatives, and part of our “Ease Of Doing Business” initiative directed at rail shippers and seeking to make rail more competitive with motor carriers for additional traffic, is pricing simplification to provide competitive through rates on a timely basis. An initial focus of this initiative with both major eastern railroads involves service improvements over the New Orleans, LA gateway, with new carload services in place with CSX and under design with NS. Given BNSF’s more direct route between many major eastern gateways and Laredo in conjunction with Tex Mex (for example, as shown on Exhibit 2, the BNSF-Tex Mex route between Laredo and New Orleans is 738 miles, compared with UP’s still shorter 724 mile route and with KCS’ 1,043 mile route), these initiatives have the opportunity to attract more business to rail from alternative modes, provided BNSF retains the ability to handle this traffic competitively with Tex Mex and TFM for Mexican customers and markets.

Overall, during the past six years, BNSF has demonstrated that it can provide effective competitive discipline to UP for traffic destined for the Laredo and Brownsville gateways. Developing that level of competition, though, has required substantial investment on the part of BNSF throughout its network to support Mexican business flows and provide competitive, marketable service offerings for shippers, and has required BNSF to leverage all of its

competitive advantages, from its broad geographic reach and extensive interline connections to its dedicated drive to provide shippers with improved and additional transportation service options and to achieve efficiencies and reduce shipping costs. In addition, BNSF's ability to provide effective competition to UP depends on the provision of commercially reasonable rates and services by both the Tex Mex and TFM, and its ability to continue to provide shippers with that competition is dependent on the continuation of such rates and services. Thus, the transaction proposed by KCS and Tex Mex could jeopardize BNSF's progress to date and thereby reduce the competitive offerings available to shippers, unless BNSF continues to receive commercially reasonable rates and service from both the Tex Mex and TFM components of the new NAFTA Rail.

II. ABSENT EFFECTIVE OPEN GATEWAY CONDITIONS, KCS COULD FORCE SHIPPERS TO DIVERT TRAFFIC TO KCS

One of the key elements to BNSF's ability to provide competitive service has been its ability to strike reasonable and stable interline pricing and contract terms with Tex Mex and TFM that provide for competitive rates and for BNSF to work cooperatively with Tex Mex and TFM to ensure efficient service for traffic traveling over those lines. While KCS has made a number of helpful "pledges" to the Board on terms and commitments under which NAFTA Rail will work with BNSF (and UP) over the Laredo and Brownsville gateways, many of the pledges lack necessary specificity. Absent continuation of existing interline working relationships with Tex Mex and TFM, perhaps through agreement on enforceable terms of open gateway agreements and their imposition as conditions, KCS has indicated that it will impose new terms and conditions for traffic traveling over Tex Mex and TFM that may restrict BNSF's access to Mexico, and thereby may prevent BNSF from providing an effective competitive alternative to UP.

Specifically, KCS stated in its Application that NAFTA Rail may not renew some pricing and marketing agreements that do not provide “adequate” revenues for a combined KCS/Tex Mex system. Application at 26-27 n.19. The BNSF/Tex Mex 1998 Laredo-Robstown interline division agreement, which covers most commodities moving between BNSF and Tex Mex for the Laredo gateway, and which is up for renewal at the end of this year, appears to be one of the contracts to which KCS refers. Further, as KCS stated in a discovery response in this proceeding, KCS has told BNSF that it “need[s] to improve the overall revenue/expense ratio for Tex Mex of handling BNSF traffic after expiration of current BNSF-Tex Mex agreements.”¹ This uncertainty is already impacting BNSF and, potentially, shippers relying on BNSF to reach south Texas and Mexico markets via Laredo and Tex Mex. For example, for customers wanting long term (beyond the end of 2003) rates in conjunction with BNSF and Tex Mex to access Laredo, BNSF cannot offer firm rates and commitments to offer customers in response to many of their inquiries. As the end of 2003 draws closer, customers’ abilities to obtain the kind of commitments they need to route their freight to and from Laredo from BNSF in conjunction with Tex Mex will grow more difficult, causing them to look to other carriers, other modes or other markets to handle their Mexico transportation and distribution needs. Waiting for the rates to expire before considering renewal, extension, or renegotiation, as suggested by KCS’ Gerald Davies’ at the July 31, 2003 Board hearing on the proposed transaction, is not responsive to shippers’ needs in this critical competitive corridor. Additionally, resolution of this issue is not of concern to UP or its customers, as UP has its own Laredo access, bypassing Tex Mex.

¹ Supplement to the Kansas City Southern Railway Company’s and the Texas Mexican Railway Company’s Responses and Objections to Union Pacific Railroad Company’s Third Set of Discovery Requests to Applicants, Supplemental Responses, served July 23, 2003, Request No. 26, at page 2.

Moreover, in its diversion analysis, KCS has projected that it will divert 4,725 cars from BNSF to KCS, which represents almost 10% of BNSF's traffic through Brownsville and Laredo.² While KCS has not specifically explained how it would achieve those diversions, given its other comments, KCS could achieve that end by raising BNSF's rates over Tex Mex and TFM such that BNSF is not able to compete against KCS for shippers that are served by both railways.

Because KCS has not submitted an operating plan to the Board, its exact operating intentions are unclear. But, there are a number of steps that KCS could take to divert traffic to the KCS system:

- First, KCS could raise rates at Robstown for any traffic going over Tex Mex unless it originates from the KCS system or is routed to give KCS its longest haul. This would artificially increase other carriers' costs, giving KCS a competitive advantage. For example, as stated in KCS' control application, "the other most significant shift comes from traffic that BNSF currently interchanges with Tex Mex at Robstown/Corpus Christi being interchanged instead with KCSR in Kansas City and moving via the commonly-controlled KCSR/Tex Mex to Laredo from that point." (Application, at 122)
- Second, KCS could raise rates at Laredo for any traffic going over TFM that again does not originate from the KCS/Tex Mex system or does not give the system its longest haul.
- Third, KCS could discriminate against competing carriers on TFM by charging higher bridge fees or by reducing the crossing access that it would charge itself. While KCS' "pledges" appear to address the first issue, the second remains – and could impact BNSF-Tex Mex traffic as compared to KCS-Tex Mex traffic.
- Fourth, KCS could cause TFM and Tex Mex to discontinue providing value-added services (such as blocking traffic, providing equipment or providing intermodal service) to KCS' competitors, preventing those carriers from offering fully-competitive services.

² This projection assumes a static state with respect to KCS' transaction with TFM. Thus, diversions are significantly understated since they do not take any potential anticompetitive steps on TFM into account.

KCS has not disclosed its actual pricing and service intentions for traffic going through Robstown or Laredo. While KCS has made a vague promise many times to keep the Laredo and Brownsville gateways “open on commercially reasonable terms,” KCS has refused to give any specific assurances as to what that will mean, beyond a statement “This is the same commitment that was made in the CN/WC and CSX/NS/Conrail merger cases and KCS will live by those commitments.” *Davies V.S.*, at 15. Absent a firm and well-defined open gateway commitment by KCS, or the imposition of a condition by the Board, KCS will be free to divert traffic to its own system without regard to the efficiency of such diversions.

As Mr. Davies reported to the Board at the July 31, 2003 hearing, KCS has reached an agreement on the NAFTA transactions with NIT League. BNSF is anxious to review and understand the terms of that agreement, but is hopeful that it will further provide the specificity on the open gateway commitment by KCS to shippers and permit this issue to be resolved.

III. TRAFFIC DIVERSION TO KCS COULD INJURE SHIPPERS

Because of several inadequacies of the KCS/Tex Mex route compared to the BNSF/Tex Mex route, the economic diversion of traffic from BNSF to KCS would in many cases reduce the quality of service available to shippers and negatively impact competition.

First, because the KCS/Tex Mex connection between Houston and Robstown is circuitous compared to BNSF’s route, a diversion of traffic to NAFTA Rail from BNSF would add to the shipping time for traffic going to Laredo. Tex Mex’s trackage rights between Houston and Robstown require trains to travel 286 miles. Rather than following the coastline as BNSF’s route, which includes trackage rights, does, Tex Mex must travel due west to Flatonia from Houston, before heading south to Robstown through Placedo. This diversion is 23% longer than BNSF’s route between Houston and Robstown. Further, Tex Mex must go through the Houston

terminal complex, while BNSF skirts around Houston from the northwest on its own line to reach its trackage rights over UP at Algoa to reach Robstown for much of its south Texas and TFM business. In all, Tex Mex's circuitry can add an often substantial number of hours of shipping time over a comparable shipment over BNSF track.³

In fact, as can be seen on the mileage chart attached as Exhibit 2, the combined KCS/Tex Mex route is longer than the BNSF/Tex Mex route from most major interconnection points across the U.S. to Laredo. For example, from Chicago, KCS/Tex Mex is 1779 miles, while BNSF/Tex Mex is 1660 miles with one less rail carrier in the route (and the dominant rail carrier in the lane, UP, has a route hundreds of miles shorter than BNSF's route). Further, KCS/Tex Mex is 304 miles longer than BNSF (44% longer) from Dallas-Fort Worth to Laredo. BNSF's ability to compete with UP and highway competition is due in part to the more direct north-south route that BNSF enjoys compared to KCS, and in part due to the circuitous nature of the Tex Mex route.

Second, KCS does not offer shippers the range of transportation services and products that BNSF can offer. For example, while BNSF moves over three million intermodal shipments per year, KCS moves comparatively few. This diminishes its ability to compete for double stack intermodal auto parts business due to the overall equipment, infrastructure and capacity requirements. Further, many customers prefer to obtain all rail service requirements from a single-source, even if they have multiple origination locations. BNSF operates one of the largest railroad networks in North America, with 33,000 route miles of track covering 28 states, which allows BNSF to serve as a single-source provider. KCS, by contrast, has less than 10% of

³ Although Tex Mex proposes to reduce this time by relaying track across an 85-mile right of way between Rosenberg and Victoria, Texas, given its projected cost of \$60-120 million (depending on a number of factors relating to infrastructure to be installed on this line), the development of that track may be years away.

BNSF's trackage (3,130 track miles), and serves only 11 states. KCS' small network footprint leaves it unable to compete for business from customers seeking a single-source provider without working with partner connections. This recognition on the part of KCS led to its establishing a number of marketing "Alliances" and agreements with connecting carriers having extensive route networks, including BNSF which, as KCS reported in its control application, was inaugurated in 2002 (Application, at 56-57). However, despite KCS' statement that this marketing agreement was entered into "in part to jointly facilitate the development of NAFTA traffic" (*Id.*), traffic to and from Mexico was specifically excluded from the agreement's application at the insistence of KCS, and neither Tex Mex nor TFM are parties to the agreement as a result.

Third, as KCS has pointed out several times, Tex Mex must operate over UP's infrastructure to connect KCSR with TFM, and has over the years and in this proceeding levelled numerous complaints about the handling of Tex Mex trains and line capacity over UP. For example, as KCS pointed out in its control application, "[A]t timetable speeds (which generally have declined since the UP/SP merger), Tex Mex's Robstown-to-Victoria trip could be made in about three hours. However, due to congestion on the Brownsville Subdivision, UP dispatchers often refuse a Tex Mex train entry onto the trackage rights line unless the crew has 5 or even 6 hours of service available" (*Id.*, at 134). Elsewhere in the control application, KCS states "[T]he diversion study also assumes that Tex Mex's operations over UP's lines will be as efficient as if Tex Mex owned those lines. Currently that is not the case. The section of UP's Brownsville Subdivision utilized by Tex Mex is often near gridlock these days . . . These delays significantly increase Tex Mex's train operating costs, including crew costs" (*Id.*, at 149). In its June 23 supplemental filing, KCS further stated "NAFTA Rail's ability to compete against UP at Laredo

depends largely upon the dispatching, maintenance, and investment practices of UP. In the end, NAFTA Rail can remain competitive only if UP is held to its promises, commitments, and agreements to provide neutral treatment to Tex Mex trains, invest in its infrastructure, and maintain service levels on the tracks used by BNSF and Tex Mex to provide a competitive alternative to UP.” (Supplement, at 22-23). These claims were repeated at the recent Board hearing. KCS’ ability as NAFTA Rail to increase its competitiveness over Tex Mex for TFM traffic could in part depend on its ability to resolve these issues with UP.

IV. TRAFFIC DIVERSION COULD FURTHER INJURE SHIPPERS BY REDUCING BNSF’S ABILITY TO SERVE AS EFFECTIVE COMPETITOR TO UP

The Board’s conditions in the UP/SP merger called for BNSF to serve as the competitive replacement for SP to ensure that there is effective competition to UP for traffic to and from southern Texas and Mexico. As discussed earlier, BNSF has invested heavily – over \$20 million in marketing costs alone – to offer service that is competitive to UP. BNSF has added additional train service (7-10 additional weekly trains to and from Laredo alone), has developed value-added services such as Mexi-Modal, and has improved its overall efficiency through cooperative agreements with Tex Mex and TFM. As a result, BNSF has increased traffic through Laredo by 87% since 1996, and its competitive presence has disciplined UP, whose prices for traffic through Laredo have remained essentially flat over the same time period. *See* 2001 Oversight Report, at 111.

Despite its success to date, BNSF remains challenged in its ability to compete against UP, which enjoys a network competitive advantage due to its more direct, efficient routings, as shown in the mileage chart in Exhibit 2. As demonstrated in Exhibit 3, BNSF traffic at Laredo declined 14.6% from 2001 to 2002, and BNSF has actually lost market share over that same time period. BNSF’s continued ability to serve as an effective competitor will depend on BNSF’s

ability to offer long-term competitive and stable interline rates and value-added services, and to maintain sufficient density on its routes.

The competitive steps that KCS may take absent clarity on its open gateway pledge and imposition of those terms as a condition by the Board may erode or eliminate BNSF's ability to remain competitive and thereby deprive shippers of competitive alternatives. For example, decreasing BNSF's traffic density to Brownsville and Laredo by 10% (as projected in KCS' traffic diversion analysis included in its control application) would eliminate almost 20% of BNSF's growth since 1996 and half of BNSF's growth since 1997. That reduction in density would squeeze BNSF's margins and could force BNSF over time to rationalize the frequency of the train service that it offers, making itself uncompetitive for other traffic of existing and potential BNSF customers in this market.

If KCS directed Tex Mex and TFM to cease cooperation with BNSF (*i.e.*, by no longer providing blocking on north-bound traffic, or improved cycle times on unit grain trains, or by no longer providing intermodal service in Mexico), BNSF would be limited in its ability to offer some of the value-added services that have helped it attract traffic.⁴ To the extent BNSF is no longer able to grow its Mexican business at historic rates, BNSF may need to reduce its marketing expenditures and reduce or even end the assistance it has provided to shippers to build out their infrastructure to provide value-added services and shift traffic to longhaul rail handling in the U.S. and Mexico. Such responses, while necessary to maintain financial feasibility of the routes, may further erode BNSF's ability to serve as an effective competitor with other carriers and modes for traffic through Laredo. While BNSF would have the option of shifting some

⁴ While KCS has stated in a letter to David Meyer dated July 21, 2003, that it will use its control over TFM to ensure that TFM "cooperates" with BNSF in providing services, that commitment should be made express through a condition in this proceeding, so that later, when pinched for competitive leverage, NAFTA Rail does not reduce such services.

portion of its Mexico traffic to TFM's competitor, Ferrocarril Mexicano (FXE), this scenario could nonetheless have a significant impact for rail shippers relying on BNSF, not only within BNSF's western U.S. service territory but on connections, both Class I carriers and shortline and regional rail carriers alike, to reach south Texas and Mexican markets served by Tex Mex and TFM.

BNSF's service through other Mexican gateways is not likely to provide effective competition to UP over the Laredo gateway. For example, BNSF's other direct access to TFM, through Brownsville, could not serve as a competitive replacement to Laredo for at least three reasons. First, the Brownsville gateway does not have the physical infrastructure or support services for handling international traffic that Laredo enjoys. For example, there is no intermodal service provided by any rail carrier in the Brownsville-Matamoros area because there is no facility there. Second, TFM's route between Matamoros and TFM's main north-south line (between Nuevo Laredo and Mexico City) has the characteristics of a lighter-density route, in keeping with the traffic volumes moving over it. Unlike TFM's core, high density/high capacity route south from Laredo, the Matamoros line has not enjoyed the benefit of major capital investments, which limits its ability to carry the volume of traffic, including time-sensitive automotive, intermodal, and other commodities that currently move through Laredo. Third, TFM's line from Matamoros passes through Monterrey to reach TFM's main north-south Laredo line, whereas the Nuevo Laredo route enjoys a bypass around Monterrey, impacting transit time and potentially bringing additional volumes and congestion to Monterrey which is not present now if usage was increased.

While BNSF may divert some traffic to El Paso or Eagle Pass, those gateways would also not provide strong competition to Laredo because (1) they are out of route for most shippers who

would ship through Laredo, (2) they lack the border crossing and yard infrastructure of the Laredo gateway, and (3) FXE may not serve the BNSF shippers' customers located on TFM in Mexico. For example, the El Paso gateway is over 500 miles out of route from Chicago compared to the UP-TFM route via Laredo. While the El Paso route can compete for West Coast traffic, the majority of Mexican intermodal business flows are between the U.S. Upper Midwest region and facilities in Mexico served by TFM. Finally, many customers' traffic is not susceptible to diversion to another gateway or Mexican connecting carrier, potentially harming customers dependent on BNSF to reach customers, markets and locations on TFM.

Moreover, although the TFM and FXE lines are supposed to be open to the other in Mexico, in practice, FXE cannot serve most shippers and receivers on TFM's line, which makes FXE an ineffective alternative for originations or terminations on TFM for other than intermodal and limited transloadable carload traffic. As KCS pointed out in a footnote in its June 23 supplemental filing, even where FXE should be obtaining additional access to TFM lines and customers in common terminal areas, such as Monterrey, that access has largely not been realized due to lengthy negotiations and court actions by both TFM and FXE keeping them from being implemented. Supplement, at 18 n. 7. Moreover, even if FXE could serve TFM points, that service would require an additional interchange, which would be both more expensive and more time consuming. Thus, for shippers such as DeBruce Grain in Creston, Iowa, for example, that ship most of their grain to the San Luis Postosi grain distribution center in Mexico served exclusively by TFM, if BNSF cannot provide efficient service on TFM through Laredo, the only remaining alternative may be for DeBruce Grain to ship its grain to other markets that may provide it a lower total return, reducing market access for this customer compared to his competitors located in other areas and on other transportation providers, including UP.

KCS cannot serve as an effective competitive replacement for SP either. First, as stated above, KCS' routes to reach Tex Mex and TFM are longer even than BNSF's from most joint and interline junction points. Given the difficulty BNSF has competing with UP's more direct routes, KCS will be at an even greater competitive disadvantage. Second, KCS does not offer the same geographic scope of single-line service that BNSF or UP can offer rail customers, making KCS less attractive to shippers with multiple origination points, or who want to single-source their rail commitments. Furthermore, shippers located in the western United States, which have enjoyed the benefit of having BNSF serve as a competitive replacement to SP, would potentially face a reduced competitive landscape. A very real and ironic possibility of KCS' actions in relation to BNSF interline access to Mexican markets could be the diversion of only a small incremental amount of the traffic KCS predicts in its control application to KCS long term, but the surrender of more traffic and future growth to UP, water/barge or truck, and not to KCS/NAFTA Rail.

V. KCS' DIVERSIONS COULD INJURE SHIPPERS IN EVERY COMMODITY GROUP

As explained above, shipping time velocity and consistency along with value added services are important factors for shippers of grain, motor vehicles and auto parts, industrial products, and intermodal traffic. If, due to discriminatory rates or other actions taken by KCS, those shippers are diverted to less efficient KCS' routes, are forced to interchange with KCS in Kansas City, or are forced to pay higher rates to ship over BNSF, those shippers would suffer competitive harm, and may switch their traffic either to UP or to non-rail alternatives. Examples of some of the potential harms faced by BNSF's customers are listed below.

Grain Traffic. Because it is such a widely available commodity, grain traffic is particularly sensitive to even small changes in shipping price and delivered cost. Grain shippers

on BNSF facing modest increases in shipping prices to Mexico, relative to other shippers and other markets, are likely to shift their traffic to other markets where they will be more competitive, or lose the business altogether to other origins, which ripples back to the ultimate producers, the farmers. Further, Mexican grain distribution companies rely on BNSF to provide them with access to a broad number of potential grain providers in the U.S., which ensures efficient grain pricing in Mexico. If BNSF's shipping customers can no longer competitively supply grain over the BNSF route, those Mexican grain distribution companies will lose access to the broad set of suppliers that BNSF was able to provide them, injuring both the Mexican distributor and the U.S. producer. Because KCS' limited reach greatly restricts its ability to originate grain, KCS could not replace the competition that BNSF provided. For example:

- The primary route to Mexico for wheat originating in the Dallas-Fort Worth area is via the Laredo gateway. If KCS were to carry this traffic, the ability for grain suppliers to compete on service and cost could be reduced as the KCS route from the Fort Worth area to Laredo is 304 miles longer than the BNSF route. Even if BNSF had to exchange the traffic with KCS at Houston, the route would still be longer than a BNSF-Tex Mex route.
- Internacional at San Luis Potosi, Mexico is a grain distribution point in Mexico, between Monterrey and Mexico city, served only by TFM. Internacional depends on BNSF to provide it with broad access to grain shippers in the U.S., and ships over 3300 cars on BNSF annually. If, as a result of the NAFTA Rail transaction, BNSF's grain shippers are less competitive shipping grain via the Laredo gateway, Internacional's ability to price shop for grain would be reduced as a result of fewer competitive supply points, and the cost of grain on TFM served points would likely increase. Moreover, Internacional is one of the customers in which BNSF has invested to help upgrade its shipping facilities to receive larger unit train shipments. If BNSF were no longer able to serve customers such as Internacional, it would likely reduce such investments because they would not pay off over time. As a consequence, shippers like Internacional would not only lose access to competitively priced grains but also to financing for infrastructure improvements.

Industrial Products. Industrial products include a wide variety of products from paper and aluminum to cement and metals. The supply points of industrial products are highly

fragmented in the U.S. The Mexican receivers that BNSF serves need to source products from multiple locations and often prefer to do that using a single carrier. Because of its broad geographic network, BNSF is able to provide such services to its Mexican receiver customers. Were KCS to increase the costs of shipping over BNSF, BNSF's Mexican receivers would suffer from the loss of competitive market access, and U.S. shippers would suffer from being denied access to Mexican markets or from a lack of a competitive alternative to UP. For example:

- Pipsamex (Mexico) buys and processes scrap paper from all over the U.S. Pipsamex will, for example, put out for bid a contract for hauling up to 3000 cars of scrap paper annually, and will use the carrier that can give it the best overall rates. Because of BNSF's broad geographic network, BNSF is able to compete against UP for that traffic. If KCS diverted BNSF's traffic to Kansas City or increased BNSF's costs to serve Pipsamex, BNSF may not be able to offer competitive service. Moreover, because KCS does not have as broad a coverage area, it could not provide Pipsamex with access to as many scrap paper shippers. Pipsamex would have to source from only those suppliers on KCS' line or its connections, thereby injuring both Pipsamex and the many scrap paper suppliers who would no longer have access to Pipsamex, or it would have to shift to using UP, thereby further lessening competition for rail traffic through Laredo.

Motor Vehicle and Auto Parts. Because of the need to supply just-in-time inventory systems in Mexico and the U.S., BNSF must provide fast and predictable shipment times to auto manufacturers to compete for motor vehicle and auto parts traffic. Moreover, because motor vehicle manufacturers prefer to contract with a single-source provider that can service most or all of their plants directly or through connections, BNSF and UP are the only effective competitors for those manufacturers. If KCS were to force BNSF to interchange motor vehicle and auto parts traffic in Kansas City rather than Corpus Christi/Robstown, BNSF would lose much of its ability to provide efficient service to Mexico, and UP would be left as the only competitive rail carrier to serve those manufacturers. For example:

- Prior to 2002, Metalsa, a supplier of automobile frames based in Monterrey, Mexico, shipped its products via TFM-UP-ALS-TRRA-BNSF to Fenton, Mo. In 2002, BNSF was able to offer Metalsa a price-competitive rate with a reduced

shipping time because BNSF served the DaimlerChrysler sequencing facility to which Metalsa shipped and was therefore able to reduce the number of traffic interchanges with a route of TFM-TM-BNSF. If KCS were to force that traffic to interchange at Kansas City, Metalsa would lose the benefit of reduced shipping time and would likely also no longer receive a price-competitive rate. The KCS route would be 418 miles longer via GWR-KCS in comparison to the BNSF route. In such a case, Metalsa would shift back to UP's service. If multiplied over several parts suppliers in Mexico which require optimum transit times, KCS' actions would leave UP virtually without a competitor for rail shipments of automotive parts.

- The DaimlerChrysler double stack auto parts bid exemplifies how BNSF imposes competitive discipline even when it does not win a contract. In 2001, DaimlerChrysler opened for competitive bidding its double-stack auto parts business to Mexico. BNSF was a finalist on the bid, as its bid was considered credible due to the broad geographic scope, efficient delivery times, equipment and infrastructure that would be needed to serve DaimlerChrysler. UP responded by not only reducing its rates on the Mexican route, but also by bundling that traffic with U.S. domestic business and reducing the price on the whole bundle. As a result, DaimlerChrysler received an effective 25-30% reduction in the cost of service to Mexico. Because KCS has neither the geographic scope, the efficient delivery times, nor the required equipment and infrastructure, KCS alone would not have been able to provide such a credible alternative to either UP or highway alternatives.

Intermodal Traffic. Intermodal traffic is one of the most time-sensitive categories of traffic. With BNSF's Mexi-Modal program, which BNSF provides in cooperation with Tex Mex, TFM, CSX and CN, BNSF is able to offer door-to-door service that can significantly reduce transit times for intermodal traffic. If KCS were to force intermodal customers to select its services over Kansas City in lieu of BNSF's more direct and extensive service offerings, or direct Tex Mex or TFM to cease cooperating with BNSF in providing those services, BNSF may be unable to provide shippers that service, and customers may opt for UP or over-the-highway options to meet their customers' transport needs instead. For example:

- Mabe, a GE Company, ships appliances from Toronto, Canada to Mexico City using the Mexi-Modal program. Mabe appliances originate on Canadian National, which interchanges the traffic to BNSF in Chicago. BNSF interchanges that traffic with Tex Mex at Robstown, which performs the necessary work (including in-bond documentation paperwork) to move the traffic through Laredo

to Mexico City on TFM. Once the load clears customs in Mexico City, the TFM Intermodal Team coordinates the final delivery (dray) to the customer's door in the Mexico City area. If BNSF were forced to interchange the traffic at Kansas City or if KCS were to direct Tex Mex or TFM to cease providing that intermodal service, BNSF would be unable to provide Mabe with this attractive service. It is highly possible that KCS would not be able to provide a competitive replacement to Mabe for this service.

Brownsville Traffic. BNSF's Brownsville gateway service primarily serves agricultural processors just across the border in Matamoros, Mexico. If KCS were to divert this traffic to the Laredo gateway, as suggested by its diversion analysis, those Brownsville customers would no longer have competitive rail service available to them. They would be forced to either use UP or to transport the products by other modes of transportation – truck or water, for example. For example:

- Regasa receives 60-70% of BNSF's traffic at Brownsville. Regasa is located in Matamoros, just across from the Brownsville rail border crossing. If KCS were to force BNSF to divert this traffic from Brownsville to Laredo, as suggested in KCS' traffic diversion analysis, the traffic would have to then travel west on Tex Mex 146 miles to Laredo, south on the TFM main line to Monterrey 165 miles, before shipping north and east 208 miles back to Matamoros creating an additional net length of haul of 383 miles. Such a lengthy diversion would probably not be supported economically, and Regasa would likely have no choice but to source its purchases from other locations (potentially outside the U.S.) or find another shipping alternative to BNSF, which would again decrease the competitive options available to shippers.

VI. AN OPEN GATEWAY CONDITION IMPOSED BY THE BOARD COULD PREVENT THESE HARMS TO SHIPPERS

The maintenance of meaningfully open gateways through Laredo and Brownsville would avoid most of the competitive harms outlined above, would not be unduly cumbersome or complex to administer, and would be consistent with the Board's guidelines and past practices. While BNSF has been encouraged that KCS has committed generally to accepting conditions to keep the Laredo and Brownsville gateways open on commercially reasonable terms and to

continuing to provide service at the same levels as the past, those commitments need to be made more specific and enforceable. Specifically, we would suggest an open gateway condition similar to the condition imposed in the CN/Wisconsin Central transaction, which KCS referred to in their June supplemental filing (Davies V.S., at 15). That open gateway commitment and condition spoke to an agreement with NIT League whereby, as applied to the NAFTA Rail transactions, the Applicants would be required to maintain BNSF's existing rates and services with Tex Mex and TFM for a five-year period, subject to RCAF-U increases, and to provide commercially reasonable rates thereafter subject to the jurisdiction of the Board.

Such conditions are not unduly burdensome and pose no threat to KCS' ability to achieve its efficiency gains from the merger. Open gateway conditions should require little ongoing monitoring by the Board, and would be far less intrusive than trackage rights or other remedies. The efficiency of open gateway conditions is apparent by the experiences of the parties following the CN/WC and the CN/IC mergers. In both cases, open gateway conditions were imposed with minimal, if any, impact on the efficiency or operational objectives of the parties.

The imposition of such a condition to maintain open gateways at Robstown, Laredo and Brownsville on a "commercially reasonable" basis would provide shippers and connecting carriers a safety net and regulatory jurisdictional backstop if the market did not function to preserve and permit the use of efficient routings in the future if and when problems developed. It would do so without unduly affecting the Applicants' ability to offer shippers the benefits of the proposed transaction.

Open gateway commitments are also consistent with the Board's guidelines and with past Board practice. In the Board's decision in Ex Parte No. 582 (Sub-No. 1), the Board provided that future major mergers would require the inclusion of open gateway commitments. Given that

the KCS/TFM control proceeding would constitute a major merger if TFM were located in the United States, imposition of the open gateway requirement is appropriate. Further, as mentioned, the Board has imposed open gateway conditions in both the CN/WC and the CN/IC proceedings that are similar, or identical to the open gateway commitments sought here. Given the Board's own precedent, requiring an open gateway commitment at Laredo and Brownsville is a measured approach that can make the benefits of the proposed transaction available to both the shippers and the Applicants.

Finally, imposition of open gateway commitments is consistent with the positions and conduct of KCS. For example, in Ex Parte No. 582 (Sub-No. 1), KCS took the position that all existing competitive shipper rail options should be preserved in future merger or control transactions. Given that position, it would be difficult for KCS to now argue that an open gateway condition is not justified.

VERIFICATION

I, Peter J. Rickershauser, verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on July 31, 2003.

A handwritten signature in black ink, appearing to read "Peter J. Rickershauser", is written over a horizontal line.

Peter J. Rickershauser

BNSF Traffic Through Laredo by Category

2002 Traffic Through Laredo
Rail Cars



* Other includes Perishable and Dry Boxcar products

Source: BNSF Traffic Data

Mileage Comparisons from Key Cities to Laredo

City	BNSF Miles	KCS Miles (% vs. BNSF)	UP Miles (% vs. BNSF)*
New Orleans	738	1,043 (+41.2%)	724 (-2.0%)
Houston	377	430 (+14.0%)	359 (-4.9%)
DFW (Alliance)	690	994 (+44.0%)	427 (-61.9%)
Chicago	1,660	*1,779 (+7.2%)	**1,354 (-18.4%)
St. Louis	1,200	1,618 (+34.8%)	1,186 (-1.2%)
Kansas City	1,230	1,289 (+4.8%)	933 (-24.1%)

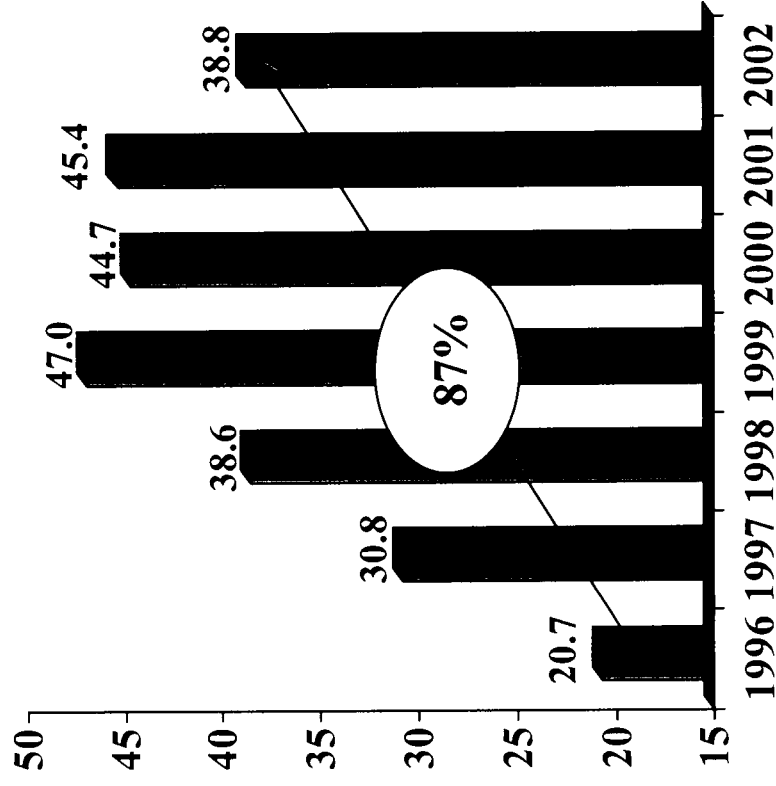
* UP/KCS Haulage Springfield - Chicago

**UP mileage assumes routing over BNSF trackage rights Kansas City to Chicago.

Growth in Traffic at Laredo and all Gateways

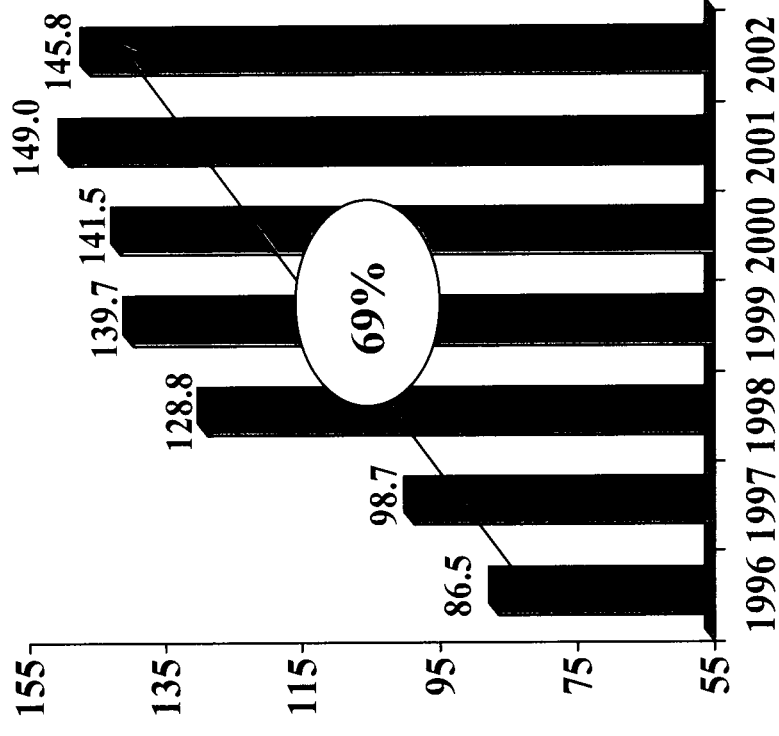
Laredo Traffic Growth, 1996-2002

Rail Cars, 000s



Mexico Traffic Growth, 1996-2002

Rail Cars, 000s



Source: BNSF Historic Traffic Data

Exhibit 3

**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**

**VERIFIED STATEMENT OF
DAVID REISHUS**

I. INTRODUCTION

I.A. Qualifications and Purpose

My name is David Reishus. I am a Senior Vice President at Lexecon Inc., and prior to its acquisition by Lexecon in 1999 was President of The Economics Resource Group, Inc. I received my Ph.D. and Master's degrees in economics from Harvard University.

I have specialized in applied microeconomic analysis and have consulted for numerous private and public clients on issues involving the economics of competition, pricing, market access, mergers, and regulation. I have worked extensively in the railroad and energy sectors, and have previously filed testimony before regulatory bodies on the operation of markets and competition. I previously have submitted testimony to the Surface Transportation Board ("STB" or "Board"), including a verified statement previously submitted in this proceeding.¹ My *curriculum vita* is attached as Exhibit 1.

¹ 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, The Burlington Northern and

I have been asked by The Burlington Northern and Santa Fe Railway Company (“BNSF”) to review potential competitive impacts of the proposed common control of The Texas Mexican Railway Company (“Tex Mex”) and The Kansas City Southern Railway Company (“KCSR”) by Kansas City Southern (“KCS”) and to analyze potential remedies or conditions that could mitigate these impacts if the transaction were approved.²

I.B. Summary

Three-quarters of the value of U.S.-Mexico trade shipped by rail goes through the Laredo gateway. Laredo and Brownsville, which are the only rail gateways connecting with TFM, S.A. de C.V. (“TFM”), are economically significant and growing more so. BNSF was granted access to the Laredo (via connection with Tex Mex) and Brownsville gateways to replace the competition lost when the rail carriers of Union Pacific Corporation (“UP”) and Southern Pacific Rail Corporation (“SP”) merged. As part of the conditions imposed on the merger, BNSF received trackage rights to reach Tex Mex at Robstown and Corpus Christi to serve traffic through Laredo. Tex Mex also received trackage rights to Beaumont in order to connect with KCS.

While UP carries a large portion of the Laredo gateway traffic, due to a superior route and the extent of its network, a BNSF-Tex Mex-TFM routing competitively disciplines the rates and service that shippers obtain for traffic through Laredo. Preservation of shippers’ competitive alternatives imposed in the UP/SP merger requires that BNSF have continued viable economic and

Santa Fe Railway Company’s Reply to Applicants’ Petition to Establish Procedural Schedule, Verified Statement of David Reishus, June 3, 2003.

² 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, Railroad Control Application, May 14, 2003 (“KCS Application”); 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, Supplement to Application, June 23, 2003 (“Supplemental Application”).

physical access to the Laredo gateway via interchanges with Tex Mex at Robstown and Corpus Christi and with TFM at Laredo.

A mechanism for ensuring the ongoing competitive discipline in the face of the proposed transactions that would place KCSR, Tex Mex, and TFM under common control is to provide that the gateways are required to remain open on commercially reasonable terms. Requiring that Tex Mex and TFM maintain the Laredo and Brownsville gateways open on a commercially reasonable basis and that a transition for some fixed period of time, such as five years, be in place to limit changes in rates and service conditions would preserve U.S. shipper interests at these U.S.-Mexico gateways.

Imposition of such an open gateway protection is a reasonable and prudent regulatory safety net against a lessening of competition, if the market does not act to provide for efficient outcomes for shippers. Experience in recent mergers demonstrates that such open gateway protections impose little risk of lost efficiencies in the merger as a result of such conditions. From a shipper's perspective, they largely provide stability and continuity over defined important interline gateways. These sorts of conditions have been offered, negotiated, or imposed with no appreciable loss of efficiency. Imposition of such conditions on the Laredo and Brownsville gateways is sound and reasonable public policy.

II. THE KCS TRANSACTION AND THE LAREDO GATEWAY

In April 2003, Kansas City Southern announced a series of agreements that would combine KCSR, Tex Mex, and TFM as wholly owned subsidiaries under the common control of KCS, to be renamed NAFTA Rail.³ The first stage of the proposed combination involves the common control of KCSR and

³ I will refer to KCS, KCSR, Tex Mex, and The Gateway Eastern Railway Company (a 17-mile short line wholly owned by KCSR) as the "Applicants."

Tex Mex by KCS.⁴ The second stage entails exchanging cash and stock so that KCS will control and own all of TFM, which operates the rail lines from Laredo and Brownsville to Monterrey and the Mexico City area, among others.

This transaction raises greater competitive issues and public policy concerns than would be typical for a primarily end-to-end merger between a Class I carrier and a Class II carrier with 157 miles of rail line. These concerns arise, in part, from the unique and important position that Tex Mex plays in international trade and from the anticipated second-stage acquisition of TFM, the connecting Mexican carrier. In addition, continued effective competition to UP for Southeast Texas and Mexico traffic by BNSF as a replacement for SP following the UP/SP merger must be considered and preserved.

The integration of the U.S. and Mexican economies has accelerated since NAFTA went into effect in 1994. Trade between the U.S. and Mexico has grown much faster than growth in either economy. The growth in rail transportation between the two countries reflects that trend; the growth in cross-border rail traffic between the U.S. and Mexico has substantially exceeded the growth in U.S. domestic rail traffic. (See Figure 1.)

Laredo is the dominant gateway for both truck and rail between the U.S. and Mexico. As shown in Figure 2, 75% of the value of rail trade between the U.S. and Mexico passes through Laredo. This is partly a result of geographic happenstance. Laredo is located on the most direct route between the major population and industrial centers of Mexico City and Monterrey and the central and eastern U.S. (See Appendix.) As such, establishment of cross-border business services and investments in the

⁴ KCS has already acquired ultimate ownership of Tex Mex (via MexRail) and is seeking approval to exercise control of Tex Mex and dissolve the voting trust into which it has been placed.

Figure 1

**GROWTH IN U.S. - MEXICO RAIL TRAFFIC HAS EXCEEDED
THE GROWTH IN U.S. DOMESTIC RAIL TRAFFIC**

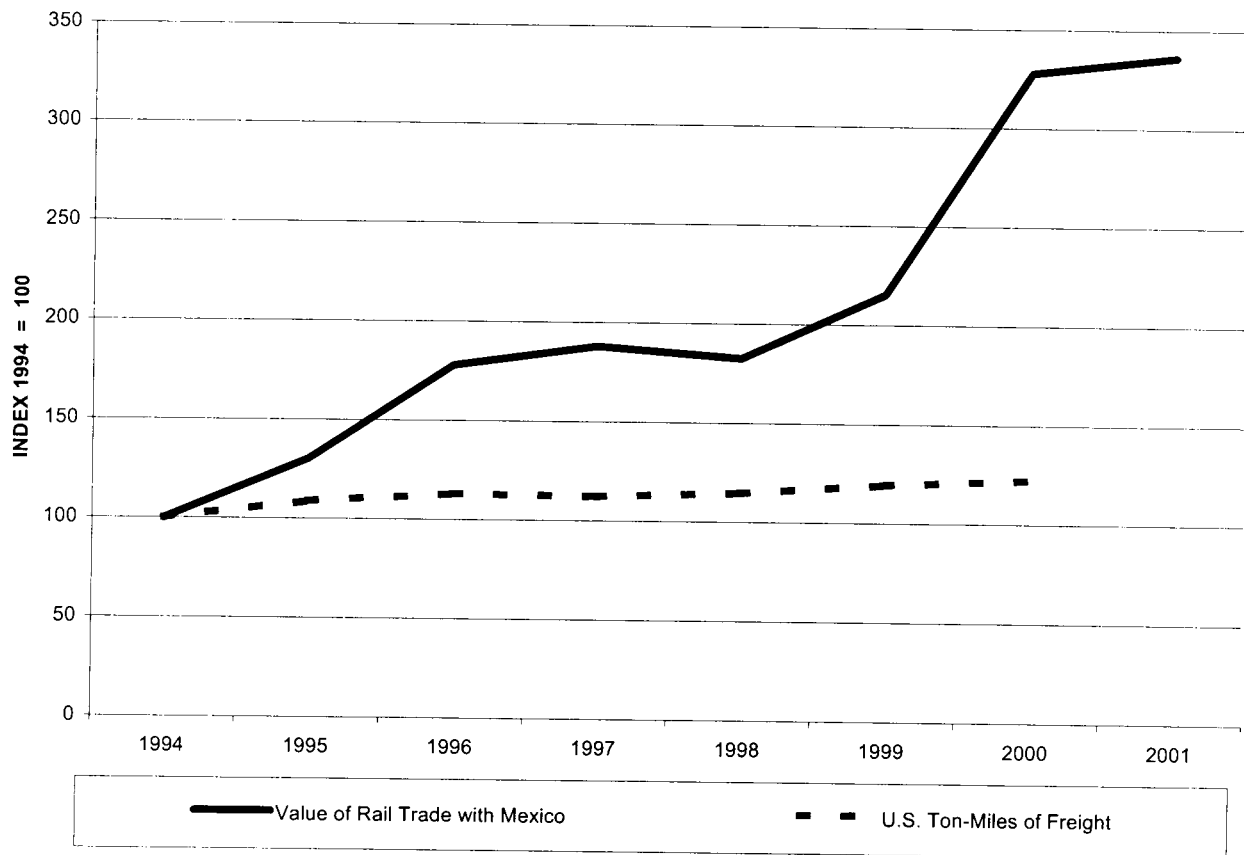
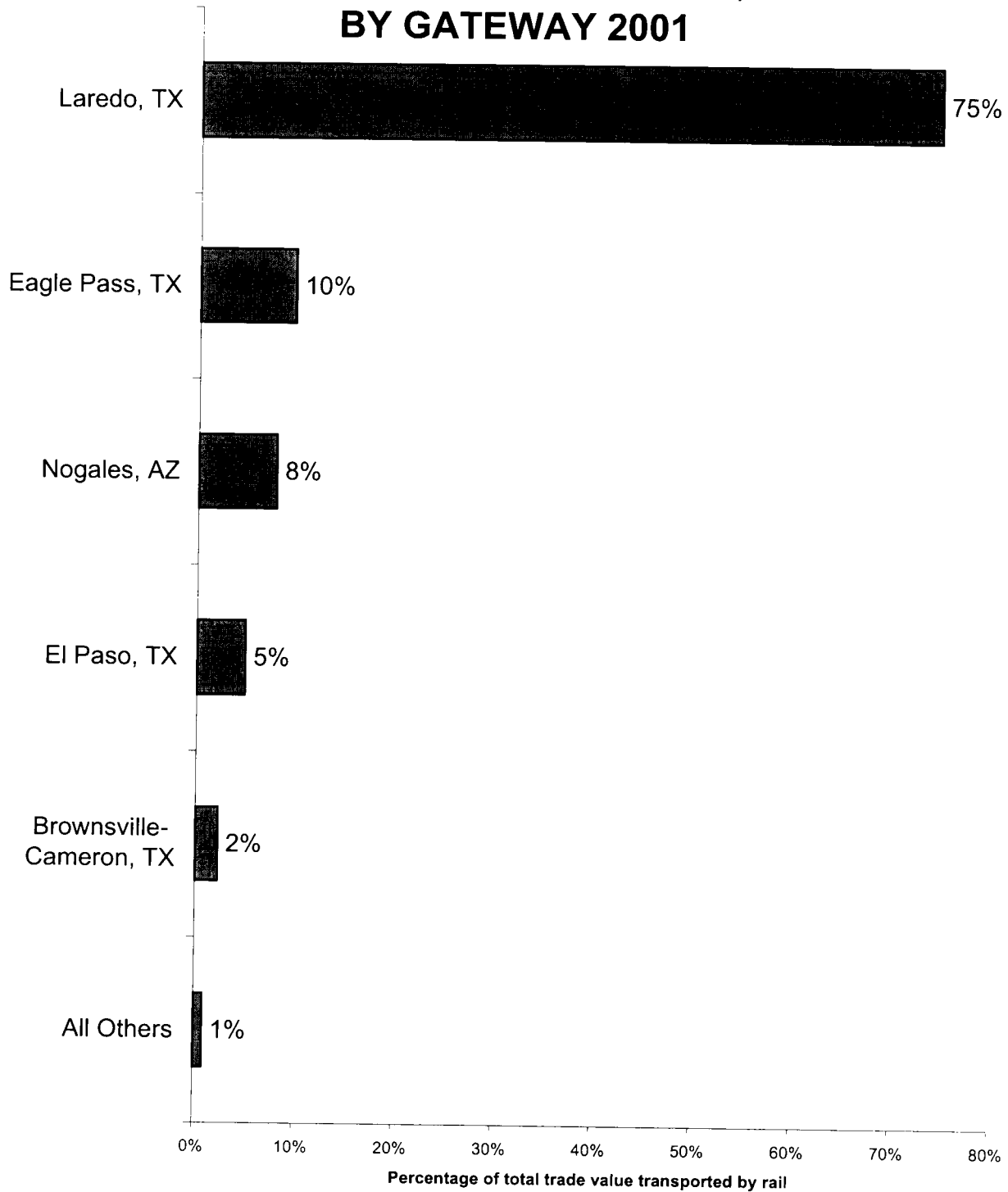


Figure 2

**PERCENT OF VALUE OF U.S.-MEXICO TRADE
TRANSPORTED BY RAIL,
BY GATEWAY 2001**



corresponding physical and organizational infrastructure have been made at Laredo to enable efficient, high-volume cross-border trade and transportation.

Tex Mex's unique significance results from its being the only railroad with U.S. access to the Laredo Mexican gateway besides UP. Tex Mex functions primarily as a bridge carrier connecting the Laredo gateway with the rest of the U.S. rail system; 80% of its traffic is interline traffic to and from Laredo.⁵ As shown in Figure 3, UP is the largest U.S. carrier at Laredo, accounting for almost 85% of the units passing through the Laredo gateway in 2001. The remaining traffic travels over the Tex-Mex system, with BNSF-Tex Mex routings having the next largest volume at 8% and KCSR-Tex Mex following with 5%. Thus, joint-line movements with Tex Mex and its upstream carriers are crucial competitive restraints on UP for traffic through the Laredo gateway.

TFM is the most important Mexican railroad for U.S.-Mexican trade. It has exclusive access on the Mexican side to the Northeastern Mexican gateways of Laredo/Nuevo Laredo and Brownsville/Matamoros and reaches the important industrial centers of Mexico City and Monterrey. TFM handles over three-quarters of the U.S.-Mexican rail trade. International freight accounts for 82% of TFM's revenue, most of which passes through Laredo.⁶ In fact, TFM enjoys the shortest route from Midwestern and eastern points in

⁵ 2001 Waybill Sample. Most traffic to and from Mexico is waybilled separately on the U.S. and Mexican side with the U.S.-Mexican border crossing (e.g. Laredo) as the listed destination or origination for traffic that is actually flowing to and from interior points in Mexico. Therefore, it may not be possible from waybill information available to U.S. railroads to identify the destination or origination in Mexico. The amount of local rail traffic to Laredo is small or non-existent, so that all rail traffic identified from waybill information as being to or from Laredo is treated as international traffic flowing through the Laredo gateway.

⁶ Grupo TMM, S.A., SEC Form 20-F, 2002, at 27. By contrast, only 30% of traffic on Ferromex, which serves the other U.S.-Mexican rail gateways, is international traffic, reflecting the relative importance of the Laredo and Brownsville gateways. <http://www.gmexico.com/gm11000.html>, July 29, 2003.

Figure 3

**PERCENT OF TRAFFIC TO AND FROM LAREDO
GATEWAY BY ROUTING, 2001**

Route	Percentage
UP	84%
BNSF - Tex Mex	8%
KCSR - Tex Mex	5%
Tex Mex only	2%
UP - Tex Mex	< 1%

Source: 2001 Waybill Sample.

the U.S. to the major industrial and population areas in Mexico.⁷ In terms of operating revenue, TFM is the largest railroad in Mexico, with revenues of \$670 million in 2001.⁸

The proposed, two-stage control transaction among KCSR, Tex Mex, and TFM is primarily an end-to-end consolidation. End-to-end rail mergers typically result in improved single-line service for some shippers and reduced costs through the capture of economies of scale and scope. Loss of Tex Mex as a neutral, non-controlled bridge carrier, however, threatens the competitive discipline that BNSF provides to UP over the Laredo gateway. Closure of access by a KCS-controlled Tex Mex to Laredo for BNSF traffic or economically inefficient pricing and service by a KCS-controlled Tex Mex would eliminate or weaken the competitive alternative provided by a BNSF-Tex Mex routing.

The risk of reduction in competitive alternatives is enhanced by the proposed second phase of the transaction, as KCS would gain control of the only Mexican railroad serving the Laredo and Brownsville gateways. TFM, currently not controlled by any U.S. carrier, serves as a neutral Mexican carrier for all combinations of traffic crossing at Laredo and Brownsville. While a KCSR-Tex Mex combination alone could effectively foreclose BNSF-source traffic from accessing the Laredo gateway, a combined KCSR-Tex Mex-TFM could additionally foreclose both BNSF and UP through Laredo.

Control of TFM by the Applicants would give KCS complete control over all possible connections through Brownsville and Laredo. With control of TFM, the proposed NAFTA Rail could engage in economically inefficient foreclosure or discrimination against BNSF-sourced traffic at Laredo and/or Brownsville. Thus, to the extent that BNSF provides a competitive discipline

⁷ Kansas City Southern Industries, Inc., SEC Form 10-K, 2000, at 5.

⁸ Association of American Railroads, *North American Freight Railroad Statistics*, May 14, 2003, at 1.

to UP at Laredo and Brownsville, this alternative could be lost or reduced if the proposed NAFTA Rail were to inefficiently favor its own traffic through its routing over the Laredo and Brownsville gateways.

III. COMPETITION AT RISK BY KCSR-TEX MEX-TFM TRANSACTION

III.A. UP/SP conditions

The existing set of rail alternatives between the U.S. and Mexico results directly from the UP/Southern Pacific ("SP") combination. Prior to the UP/SP merger, only UP and SP-Tex Mex routings reached the Laredo gateway, and only UP and SP served the Brownsville gateway. As part of a settlement agreement upon which the UP/SP merger was conditioned, BNSF assumed the competitive role of SP so that BNSF would have access to Laredo through connection with Tex Mex and direct access to Brownsville. In addition to the competitive alternative provided by the BNSF-Tex Mex combination to Laredo, the Board granted Tex Mex a connection to KCSR by which KCSR could interchange with Tex Mex to reach Laredo. Because of the UP/SP merger agreements and conditions, Tex Mex became a neutral, independent bridge carrier capable of interlining with both BNSF and KCSR in competition with UP for traffic to and from the Laredo gateway.

The BNSF settlement agreement, on which the UP/SP merger was conditioned, "anticipated that BNSF would replace SP as an independent interline partner for Tex Mex traffic bound to and from Laredo."⁹ The Board

⁹ Before the Surface Transportation Board, Finance Docket No. 32760, Union Pacific Corporation, Union Pacific Railroad Company, and Missouri Pacific Railroad Company -- Control and Merger -- Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp., and the Denver and Rio Grande Western Railroad Company, Decision No. 44, Decided: August 6, 1996, at 148; and Before the Surface Transportation Board, Finance Docket No. 32760, Union Pacific Corporation, Union Pacific Railroad Company, and Missouri Pacific Railroad Company -- Control and Merger -- Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp., and the Denver and Rio Grande Western Railroad Company, Decision No. 62, Decided: November 27, 1996, at 7.

also provided Tex Mex limited access to Beaumont, Texas, in order to connect with KCSR. This additional condition was imposed to enhance competition with UP over the Laredo gateway and promote continued service by Tex Mex.

The agreements and conditions imposed in the UP/SP merger have maintained the competitive alternative that would otherwise have been lost. BNSF interlined 45,395 units of traffic with Tex Mex through the Laredo gateway in 2001, compared to 25,345 cars handled by Tex Mex at the gateway from all sources between June 1995 and May 1996.¹⁰ Tex Mex traffic through the Laredo gateway from all sources has more than doubled since the UP/SP merger.¹¹ BNSF interline traffic currently accounts for more than half of the traffic received by Tex Mex.¹² Concerns that BNSF could not provide Tex Mex sufficient traffic to act as a competitive counterweight to UP have proven to have been unwarranted.

As detailed in the UP/SP oversight proceedings and the Verified Statement of Peter Rickershauser, competition between UP and an independent Tex Mex/BNSF routing for traffic to the Laredo gateway has provided an effective competitive restraint on UP. It has served to suppress rail transportation rate increases from UP over the gateway and has resulted in numerous shippers switching carriers and benefiting from price and service competition between UP and BNSF-Tex Mex for traffic bound to the Laredo gateway.¹³ BNSF need not carry the traffic for shippers to benefit from BNSF competition for Laredo gateway traffic; the experience of

¹⁰ Verified Statement Peter J. Rickershauser; Before the Surface Transportation Board, Finance Docket No. 32760 (Sub-No. 21), Union Pacific's Fifth Oversight Report, 2001, at 13 ("Fifth Oversight Report").

¹¹ 2001 Waybill Sample.

¹² Before the Surface Transportation Board, Finance Docket No. 34342, Application of the Kansas City Southern Railway Company, Gateway Easter Railway Company, and The Texas Mexican Railway Company, Verified Statement of Curtis M. Grimm, May 12, 2003, Table 3.

¹³ Fifth Oversight Report at 10 and Confidential Appendix E.

Daimler-Chrysler described by Mr. Rickershauser is just one specific, vivid example of how shippers benefit from better service and/or lower rates.

The BNSF-Tex Mex routing provides a unique competitive constraint on UP. BNSF is the only carrier in the west capable of providing competition to UP over the range of its network; KCSR lacks the rail network to provide the competition that BNSF-Tex Mex can provide. For example, approximately a third of BNSF traffic over Laredo and 80% of Brownsville traffic consist of grain and grain by-products delivered to Mexico.¹⁴ Despite UP's dominant share of traffic over Laredo, BNSF carries over a quarter of the Laredo gateway traffic to and from the tier of grain belt states from Oklahoma to North Dakota.¹⁵ KCSR-Tex Mex lacks the network scope to provide an adequate replacement for the competition provided by BNSF-Tex Mex.

A review of the U.S. rail network confirms this conclusion. Figure 4 shows the relative distance from representative originations and interchange locations through the Laredo gateway. As can be seen in each case, a KCSR-Tex Mex routing would increase the length, circuitry and, most likely, cost and travel time relative to a BNSF-Tex Mex routing over Laredo. Single-line service created by an end-to-end merger may create service improvements or cost reductions that may be attractive to shippers, despite a somewhat longer haul. Shippers would be harmed, however, if KCS were to force traffic onto itself by inefficiently altering rates and service on Tex Mex (or TFM) for traffic interlined from BNSF. By reducing the competitive discipline that BNSF could provide, such behavior by KCS would reduce the degree of competitive constraint on UP for traffic to Mexico.

¹⁴ Verified Statement of Peter J. Rickershauser.

¹⁵ 2001 Waybill Sample.

Figure 4

DISTANCE FROM SELECTED ORIGINS TO LAREDO

City Name	BNSF-Tex Mex (miles)	KCS-Tex Mex (miles)	Additional Circuity of KCS-Tex Mex Route compared to a BNSF-Tex Mex Route (percent)
Chicago	1,660	1,779	7%
DFW (Alliance)	690	994	44%
Houston	377	430	14%
Kansas City	1,230	1,289	5%
New Orleans	738	1,043	41%
St. Louis	1,200	1,618	35%

BNSF has made significant investments in expanding its U.S.-Mexico traffic including and especially through the Laredo gateway. As detailed by Mr. Rickershauser, since 1996, BNSF, among other activities, has:¹⁶

- Increased its annual marketing expenditures for Mexican traffic by over 1000%;
- Added 7-10 additional trains each way per week over the BNSF-Tex Mex line;
- Developed value-added services, such as the Mexi-Modal service, and integrated dock-to-dock carload pricing and service;
- Helped Mexican customers finance and build track expansions at their facilities to facilitate shift to use of rail transportation;
- Developed efficient unit grain train services in partnership with TFM by focusing on cycle times for train cars;
- Partnered with Tex Mex and TFM to improve through-train efficiency by managing the “Despacho Previo” process.

The results of these efforts have been double-digit growth in traffic to Mexico, including over the Laredo and Brownsville gateways.

BNSF-Tex Mex and KCSR-Tex Mex routings through Laredo provide the only *intramodal* competition to UP by which to discipline rates and service UP offers to shippers for traffic to and from Mexico. UP retains a very large share of the rail traffic through Laredo, and viable and active rail alternatives provide a source of competition for some commodities that cannot be matched by other modes of transportation. As previously explained to the Board, rail-on-rail competition between BNSF-Tex Mex and UP has served to reduce rates and improve service to numerous, specific customers

¹⁶ Verified Statement of Peter J. Rickershauser.

for traffic through Laredo.¹⁷ The competitive discipline of the BNSF alternative benefits shippers

For many types of traffic, trucks and other transportation modes could not prevent harm to shippers if BNSF-interline traffic were denied viable rates and service through the Laredo and Brownsville gateways. Trucks are not effective competitors for many types of rail traffic, especially over long distances. Over half of the value of U.S. exports carried by rail through Laredo is destined for Mexico City and the neighboring state of Mexico, a distance of approximately 800 miles from Laredo.¹⁸ While Texas exports more than any other state through the Laredo rail gateway, nearly half of the value of goods exported to Mexico by rail through the Laredo gateway comes from the industrial states of Illinois, Indiana, Ohio, Michigan, and Pennsylvania.¹⁹ A trip from Chicago to Mexico City is approximately 2100 miles, a distance at which railroads hold a competitive advantage over trucks for transportation of many commodities.

Similarly, transportation by ship and barge can provide competition for some shippers and bulk commodities between the U.S. and Mexico, but it cannot provide competitive discipline for all.²⁰ For example, while rail

¹⁷ Fifth Oversight Report at Confidential Appendix E.

¹⁸ U.S. Department of Transportation, Bureau of Transportation Statistics, Transborder Surface Freight Data; <http://www.tfm.com.mx/english/somos/infraestructura.html>, July 30, 2003.

¹⁹ U.S. Department of Transportation, Bureau of Transportation Statistics, Transborder Surface Freight Data.

²⁰ Although KCS argues here that truck alternatives obviate the need for conditions, Dr. Grimm took the position that truck and water competition were insufficient in his testimony on behalf of Tex Mex when Tex Mex was seeking trackage rights conditions over UP in 1996. See Verified Statement of Curtis M. Grimm, filed March 29, 1996, in Finance Docket No. 32760 (Sub-No. 13); excerpt attached as Exhibit 2. There, he stated that “[a]lthough truck and water play an important role overall in transportation of goods between U.S. and Mexico, many shippers of many commodities are dependant upon rail competition for competitive transportation options.” *Ibid.* at 128-129. The United States Department of Agriculture (“USDA”) has suggested that grain and grain products may be highly susceptible to intermodal competition. (USDA Comments filed July 25, 2003.) Dr. Grimm in 1996 pointed to the USDA’s reports to explain his conclusion about the ineffectiveness of truck and

accounts for a minority of U.S. grain exports to Mexico, not all Mexican grain receivers are located in places for which delivery from Mexican ports represents competitive alternatives to rail shipments. Also, to the extent that U.S. exporters face higher costs of shipping to Mexico due to actions by the proposed NAFTA Rail at the Laredo and Brownsville interchanges that limit BNSF's ability to compete, these exporters will be forced to accept lower net prices for their product and possibly seek alternative outlets for their products with concomitantly lower netback prices.

The Houston/Gulf service crisis of 1997-98 was a recent, painful episode that demonstrated vividly the limits of intermodal competition and competition provided by alternative Mexican gateways. The service meltdown, among other things, backed up rail exports at Laredo and prevented timely shipments of product through that gateway. A number of shippers turned to trucks, in some cases, to prevent the shutdown of factories, but returned to rail when rail service reverted to normal. If other modes and other gateways were truly effective competition for rail, then the rail service disruption at Laredo would have had little impact on shippers. The very public harm suffered by shippers during the service crisis demonstrates the importance of rail-on-rail competition for U.S.-Mexican traffic across the Laredo gateway.²¹

water as an alternative to long-haul rail transportation. Verified Statement of Curtis M. Grimm, March 29, 1996 at 129-130. If the Board had concluded that truck and water competition could act by themselves as a replacement for rail-on-rail competition, there would have been no need to condition the UP/SP merger on the BNSF accessing Laredo and Brownsville (as part of the UP-BNSF Agreement). Moreover, there would have been certainly have been no basis for introducing a third rail access option by connecting Tex Mex with KCS for Laredo traffic.

²¹ "Ford, Chrysler Trucks Piling Up: Transport Firms' Merger, Rail Car Shortage Delay Shipping," *The Globe and Mail*, April 28, 1998; "The Western Rail Service Crisis: One Year Later," Economic Research Service/USDA, *Agricultural Outlook*, December 1998.

III.B. TFM and Mexican Railroad Privatization

At the time the UP/SP merger was proposed, the Mexican railroad system was owned by the Mexican government. In May 1995, Mexico's government enacted a new law that paved the way for privatization of Mexico's railways. Privatization involved dividing the state-owned railway company into a number of regional systems and then selling to private investors concessions to operate them. The three main railway systems were the Northeast Railway (connecting the Laredo and Brownsville gateways to Monterrey, Mexico City, and ports on the Pacific and Gulf coasts), the Pacific-North Railway (connecting the Eagle Pass, El Paso, Nogales, and Calexico gateways to Guadalajara, Mexico City, and ports on the Pacific and Gulf coasts), and the Southeast Railway (connecting Mexico City to ports on the Gulf coast).

The Mexican rail privatization imposed barriers to a majority foreign ownership of the new concessions, limiting the risk of control by a U.S. carrier.²² It was anticipated in 1995 and 1996 that the resulting privatized Mexican rail companies would provide neutral, competitive access to shippers in Mexico and for international traffic from the U.S.²³ In December 1996, after the approval and implementation of the UP/SP merger, the Mexican government announced that TFM, a joint-venture owned 49% by KCS and 51% by Transportacion Maritima Mexicana (TMM), had won the bidding for

²² Mexican railroad privatization explicitly denied majority foreign ownership of any concession. The National Commission on Foreign Investment (CNIE), however, had the authority to override this provision. (*Ley Reglamentaria del Servicio Ferroviario*, Article 17.)

²³ Mexican law states that concessionaires have to provide service in an equitable way (*Ley Reglamentaria del Servicio Ferroviario*, Article 24, May 12, 1995). In addition, Mexico's railway regulations explicitly provide for non-discriminatory treatment of shippers (*Reglamento del Servicio Ferroviario*, Article 170, September 30, 1995). TFM's concession title, awarded in December 1996, further stipulates that TFM must provide terminal and interchange services to interconnecting foreign railroads on an equitable and non-discriminatory basis. It also states that in setting rates, TFM cannot engage in unwarranted price discrimination. (Supplemental Application at 30 and Appendix 1: "Memorandum Summarizing Features of Mexican Law and the TFM Concession Relevant to Issues Arising from Sections 1180.1(K) and 1180.11.") See discussion below regarding implementation.

Northeast Railway concession.²⁴ At the time when the Northeast Railway concession was awarded to TFM, it accounted for 40% of Mexico's rail cargo, and its network passed through Mexican states composing 69% of Mexico's population and accounting for over 70% of Mexico's gross domestic product.²⁵

While U.S. rail interests have maintained minority ownerships in Mexican rail concessionaires, the Mexican railroads have not been controlled by U.S. carriers and have served as neutral interline partners with U.S. railroads over the border. As such, TFM has had the incentive to work with each of the competing U.S. rail connections in a neutral manner to grow and enhance the value of international traffic for itself. Available evidence indicates that TFM has worked with each of the interconnecting U.S. carriers to develop international business. Examples of this neutral, pro-competitive behavior by TFM include:

- TFM has entered into partnerships with all three connecting railroads, UP, BNSF, and KCS, to offer intermodal service between the U.S., Canada, and Mexico²⁶;
- TFM has collaborated with BNSF (and Tex Mex) to improve service to Mexico, for example, by increasing the efficiency of unit grain trains and by improving through-train efficiency²⁷;
- TFM has built and subsequently upgraded key facilities to improve the handling of U.S.-Mexico traffic, such as the Sanchez yard at Nuevo Laredo, which benefits all U.S. railroads serving U.S. Mexico traffic.²⁸

²⁴ TFM began operation in June 1997. <http://www.tfm.com.mx/english/somos/somos.html>, July 28, 2003.

²⁵ Kansas City Southern Industries, SEC Form 10-K, 1997, at 2, 58.

²⁶ BNSF, "BNSF Launches Mexi-Modal – A Transborder Intermodal Service," June 28, 2001; KCS, "Kansas City Southern Introduces Time-Definite Intermodal Service in Mexico," April 21, 1999; "New intermodal service agreement to link Canadian and Mexican Destinations," *World Trade*, June 1, 1999. In fact, BNSF officials have stated that "(Kansas City Southern Railway) has a relationship with (Transportacion Ferroviaria Mexicana, a Ferromex competitor) as well, but from our perspective, we're treated fair and equal by TFM and Ferromex management and feel we get a very fair opportunity doing business in Mexico." "Opening El Paso," *Traffic World*, May 20, 2002.

²⁷ Verified Statement of Peter J. Rickershauser.

Maintenance of the competitive replacement for SP represented by an independent BNSF-Tex Mex routing requires that TFM and Tex Mex both continue to be willing and cooperative partners with BNSF. Preservation of open gateways between Tex Mex and TFM at Laredo and Tex Mex and BNSF at Robstown and Corpus Christi, discussed below in more detail, is a necessary condition for the competitive replacement for SP to be sustained. Moreover, TFM's continued cooperation with BNSF-Tex Mex at Laredo and with BNSF at Brownsville on economically reasonable terms is necessary for BNSF to continue to be an effective competitor with UP.

IV. PRESERVATION OF OPEN GATEWAYS

The preservation of competition for U.S.-Mexican rail traffic requires the preservation of open gateways through Laredo to carriers other than those of the proposed NAFTA Rail. Competition between the UP-TFM and BNSF-Tex Mex-TFM routings requires that the gateways controlled by NAFTA Rail – the combined KCSR, Tex Mex, and TFM – be open at economically efficient rates and service conditions.

IV.A. Public Policy of Open Gateways

In its recently promulgated Major Rail Consolidation Procedures, the Board recognized that "...because most inefficient gateways now have either been closed or move only minimal traffic, major existing gateways should be kept open in future mergers."²⁹ The Board has acknowledged that gateways need to be open both physically and economically.³⁰

²⁸ "Mexico: Pesos for progress," *Railway Age*, October 1, 1999; TFM, *Report to Customers 2001*, <http://www.tfm.com.mx/english/nuevo/info2.html>, July 29, 2003.

²⁹ Surface Transportation Board, Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures, June 11, 2001, at 33.

³⁰ *Ibid.* at 8.

While preservation of existing gateways has become part of the new merger process applicable to Class I railroad mergers, the imposition of open gateway requirements has also become the norm even in rail control transactions to which the new regulations have not applied. In the Canadian National (“CN”)-Illinois Central (“IC”) transaction, the Board imposed a condition requiring that the merging parties maintain the Canadian Pacific (“CP”)-IC gateway in Chicago open and competitive.³¹ This condition was imposed despite the recognition of CN/IC’s stated economic incentive and intent to keep the gateway open and competitive.

Similarly, in a 2001 control transaction between a Class I railroad, CN, and a Class II railroad, Wisconsin Central (“WC”), the Board imposed conditions to “keep all existing active gateways affected by the Transaction open on commercially reasonable terms.”³² The CN/WC transaction, like the one at issue here, was classified as a “minor transaction.”³³ As a mechanism to fulfill this requirement, CN/WC entered into an agreement with The National Industrial Transportation League that required the establishment and maintenance of commercially reasonable contract through-rates on all its active gateways, that restricted any increase in their portion of common carrier through-rates for five years to a measure of railroad cost increases, and that precluded the closure of any active interchange after the five-year period by any commercially unreasonable means.³⁴

³¹ Surface Transportation Board, Finance Docket No. 33556, Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated -- Control -- Illinois Central Corporation, Illinois Central Railroad Company, Chicago, Central and Pacific Railroad Company, and Cedar River Railroad Company, Decision No. 36, Decided: May 21, 1999, at 37.

³² Surface Transportation Board, Finance Docket No. 34000, Canadian National Railway Company, Grand Trunk Corporation, and WC Merger Sub, Inc. -- Control -- Wisconsin Central Transportation Corporation, Wisconsin Central Ltd., Fox Valley & Western Ltd., Sault Ste. Marie Bridge Company, and Wisconsin Chicago Link Ltd., Decision No. 10, Decided: September 5, 2001, at 13.

³³ *Ibid* at 3.

³⁴ *Ibid* at 12-13.

These modern gateway commitments are easily distinguished from the anticompetitive and discredited “DT&I conditions” that the ICC routinely imposed in the past.³⁵ The DT&I conditions, which rigidly froze in place rates and interchanges as part of merger approval, were imposed on an overly regulated rail industry in desperate need of network rationalization and effectively required that rates be frozen indefinitely over routes and interchanges, no matter how circuitous, insignificant, or inefficient. The DT&I conditions functioned as an anticompetitive barrier to necessary rationalization of the rail industry. By contrast, the current gateway requirements are focused on specific significant gateways, impose specific rate caps for only limited terms (five years) subject to cost-related increases, and require only that the gateway be open on commercially reasonable terms thereafter. The commitments do not preclude procompetitive rate reductions in response to changing marketplace conditions. Rather, these gateway requirements provide a competitive transition for shippers in the face of the loss of a neutral connection and provide a regulatory backstop to actions of the newly merged parties.

IV.B. Tex Mex and the Laredo Gateway

BNSF provides competition to UP through the Laredo gateway by interlining with Tex Mex at its eastern interchanges at Robstown and Corpus Christi.³⁶ Tex Mex currently provides a neutral bridge movement between these eastern interchanges and Laredo, where it interlines with the currently neutral TFM at the international bridge to reach locations in Mexico. Thus,

³⁵ Detroit, T. & I.R. Co. Control, 275 I.C.C. 455, 492-93 (1950). See also Rulemaking Concerning Traffic Protective Conditions In Railroad Consolidation Proceedings, 366 I.C.C. 112 (1982), rev'd on other grounds *sub nom. Detroit, Toledo & Ironton R.R. v. United States*, 725 F.2d 47 (6th Cir. 1984); and Curtis M. Grimm, Clifford Winston, and Carol A Evans, “Foreclosure of Railroad Markets: A Test of Chicago Leverage Theory,” *Journal of Law & Economics*, vol. 35, 1992, at 298-299.

³⁶ The nature of competition at Laredo and BNSF's role in replacing lost alternatives from the merged UP/SP is discussed in more detail in the next section.

the Laredo gateway consists of multiple components. An open Laredo gateway requires that Tex Mex's eastern interchanges at Robstown and Corpus Christi remain open **and** that Tex Mex and TFM maintain the interchange at Laredo open. An open Laredo gateway requires an obligation on both Tex Mex and TFM to preserve the gateway.

Inefficient impediments to interchange at either end of Tex Mex, whether physical or economic, would reduce or eliminate the competitive discipline provided by a BNSF-Tex Mex routing. Thus, any open gateway commitment from Tex Mex must be sure to clarify that the gateways at both the western and the eastern ends of the line remain open.

IV.C. TFM

The two-stage structure of the proposed NAFTA Rail complicates the issue of preserving open gateways. A KCSR-Tex Mex combination may lack the power to bar UP from utilizing the Laredo gateway, but it could exclude or deter BNSF from competing for interline traffic through Laredo. Conditions on Tex Mex that preserve BNSF's competitive ability to reach the Laredo gateway through a BNSF-Tex Mex routing, however, are not sufficient to preserve an open Laredo gateway in light of the proposed second-stage control of TFM. Control of TFM by KCS is sufficient to foreclose BNSF and UP from both the Laredo and the Brownsville gateways, regardless of the conditions imposed on Tex Mex.

Mexican and U.S. rail systems operate under different rules and regulations. Yet, it is necessary to coordinate operations, rates, service and policy to permit an efficient North American rail transportation network. The U.S.-Mexican border acts as a "seam" in the market rules and regulatory oversight, and that "seam" represents a potential source of market inefficiency and regulatory avoidance. Uncoordinated oversight and mismatched market rules at the seams between jurisdictions are common problems in regulated network transportation industries. The opportunity to

game the disparate rules to achieve an anticompetitive outcome may be enhanced by common control of transportation facilities across the regulatory seam by a single market participant. For example, different rules in the U.S. and Mexico may permit a commonly controlled rail entity to take anticompetitive actions on one side of the border that would not be allowed on the other but which would have cross-border effects and which would not be in the interests of shippers. To the extent that regulatory consistency across the seam can be established, pro-competitive impacts of market rules and regulation can be maintained.

Mexican rail concessionaires have exclusive rights to operate over their lines.³⁷ However, with the objective of giving access to at least two railroads to main cities such as Mexico City, Monterrey, and Guadalajara, the concessions stipulated that the concessionaire must provide trackage rights and access to certain locations to other companies. The government's intention was for the concessionaires to negotiate among themselves the appropriate fees for the mandatory trackage rights specified in the concession titles, but in the event that they were unable to reach an agreement, the Secretariat of Communications and Transportation (SCT) could intervene and set rates.³⁸ In addition, Mexican law states that mandatory trackage rights should be granted under "equal conditions and in a non-discriminatory way."³⁹

The degree of competition and access in the Mexican rail system, however, has not developed as it was anticipated at the time of the UP/SP merger following passage of Mexican rail privatization legislation. In practice, the issue of trackage and hauling rights has been contentious since

³⁷ Concessionaires effectively have exclusive rights during the first thirty years of the concession. J. Campos, "Lessons from railway reforms in Brazil and Mexico," *Transport Policy*, 8 (2001), at 91.

³⁸ *Ibid.*; *Reglamento del Servicio Ferroviario*, Articles 107, 109.

³⁹ *Reglamento del Servicio Ferroviario*, Article 109.

the Mexican railroads were privatized. The competition envisioned in the original privatization plan has not been realized. For example, Ferromex has attempted to obtain trackage rights over TFM from Ramos Arizpe (near Monterrey) to Querétaro (near Mexico City), a key north-south route for the automotive industry.⁴⁰ Ferromex accused TFM of demanding excessive fees to access Monterrey and in 2001 asked the Federal Competition Commission (CFC) to intervene.⁴¹ The CFC stated that in calculating trackage right fees, the concessionaire ought to act in a non-discriminatory way to avoid undue displacement of the company requesting the trackage rights. The CFC also stated that the exclusive rights granted in the concessions were not intended to result in restrictions to competition.⁴²

Despite the Commission's opinion, TFM and Ferromex continued their dispute over trackage rights, and in August 2002 the SCT issued resolutions requiring that TFM grant trackage rights to Ferromex in Monterrey and that Ferromex grant TFM trackage rights in Altamira.⁴³ Given the inability of TFM and Ferromex to determine acceptable fees, the SCT calculated the fees to be charged by each of the companies, but those have been contested by the parties.⁴⁴ In 2002, the SCT issued draft rules governing trackage, haulage, and interconnection rights, but to this date, the terms are still being contested by the railroads, and no final resolution has been reached.⁴⁵ In the meantime, in August 2002 the CFC opened an investigation into possible

⁴⁰ "Railroad Shippers Still Caught in a Mexican Standoff," *Journal of Commerce*, March 8, 1999.

⁴¹ "Grupo Mexico Seeks Antitrust Ruling in Rail Dispute," *Dow Jones International News*, March 22, 2001.

⁴² Comisión Federal de Competencia, *Informe de Competencia Económica 2001*, at 82.

⁴³ "SCT issues rulings on line usage rights between Ferromex and TFM," *Corporate Mexico*, August 16, 2002.

⁴⁴ Grupo TMM, S.A. de C.V., SEC Form 20-F, 2001, at 13; Grupo TMM, S.A., SEC Form 20-F, 2002, at 18-19.

⁴⁵ "More LatAm Infrastructure News," *Business News Americas*, October 14, 2002.

anticompetitive, monopolistic behavior by all Mexican railroad companies.⁴⁶ This investigation is still in process.⁴⁷

While TFM has provided a neutral connection for U.S. carriers to date, it is unclear whether and to what extent existing Mexican regulatory practice will prevent anticompetitive behavior of a KCS-controlled TFM. Preservation of effective competition for U.S.-Mexican rail traffic requires that TFM maintain the border gateways open physically and economically and that competitive protections provided to shippers on one side of the border for international traffic are not undone by actions on the other side.

IV.D. Proposed Open Gateway Conditions

The KCS Application clearly contemplates that the Robstown, Corpus Christi, and Laredo interchanges will remain economically open to all parties, as the projection of diversions contemplates that BNSF will continue to interchange a significant volume of traffic over the existing gateways. Moreover, the Applicants pledge to “keep the Laredo gateway open on commercially reasonable terms,”⁴⁸ and expect and accept that an open gateway requirement will be imposed at the gateways (Laredo and Brownsville) as a condition of the Board’s approval of KCS’s control of Tex Mex.⁴⁹ An open Laredo gateway requires that, first, the BNSF-Tex Mex interchange at Robstown/Corpus Christi remain open; second, the Tex Mex-TFM interchange at Laredo remain open regardless of whom Tex Mex interlines with in the U.S.; and, third, the TFM interchange with UP and Tex Mex remain open regardless of interline movements in the U.S. An open

⁴⁶ “Investiga la CFC a ferrocarriles,” *Reforma*, August 15, 2002

⁴⁷ The findings have not yet been made public.

⁴⁸ Supplemental Application at 24.

⁴⁹ Transcript of Testimony of Gerald Davies, COO of KCS, at Public Hearing on Proposed “KCS-Tex Mex”-Railroad Merger, July 31, 2003, at 44-45. He continues that “Those kinds of conditions are conditions that simply will foster the development of that marketplace.”

gateway commitment at Laredo and Brownsville is a very modest intervention to preserve existing competitive options.⁵⁰

The Applicants state they intend to “honor the terms of all marketing and pricing agreements involving Tex Mex and TFM” and will “not seek to cancel them early.”⁵¹ However, “... KCS is not willing to simply renew such an agreement under the old terms without undertaking a good faith negotiation.”⁵² Thus, unlike the open gateway commitments that have been made in recent mergers, KCS has indicated an unwillingness to limit rate and division increases for any period beyond the expiration of existing agreements. In the CN/WC transaction, by contrast, limitations to preserve existing competitive gateway rates and conditions were made for five years.

Application of open gateway conditions on the Laredo and Brownsville gateways that limits increases in rates over a fixed period, such as five years, is a reasonable public policy accommodation to preserve competition and shipper options. The interchanges at Laredo are obviously major, efficient interchanges that experience growing traffic levels; there is no risk that inefficient routings will be preserved in the foreseeable future. As recent merger proceedings prior to this one show, these rate and service restrictions have been offered, negotiated, or imposed by or on the merging parties in a manner that has been acceptable to the parties. These restrictions do not appear to have diminished the efficiency gains that the mergers generate nor do they appear to have deterred the merging parties from completing their transactions and capturing these gains. The Applicants have provided no evidence of any harm that would result from the preservation of existing

⁵⁰ This is recognized by KCS. In discussing the open gateway protections, the KCS COO states, “Those kinds of conditions are conditions that simply will foster the development of that marketplace.” *Ibid.* at 45.

⁵¹ Supplemental Application at 26.

⁵² *Ibid.*

competitive conditions for a limited period of time that would outweigh the protection that they provide to competition and shippers.

V. PAST AND PRESENT BEHAVIOR OF KCS WITH RESPECT TO TEX MEX-BNSF SERVICE

Past and present behavior of KCS with respect to Tex Mex-BNSF interline service raises heightened concerns about the willingness of KCS to engage in economically efficient and commercially reasonable arrangements with BNSF once it gains control of Tex Mex (and/or TFM). In early 1998, BNSF negotiated a division and marketing agreement with Tex Mex. This agreement was intended to allow BNSF to market BNSF-Tex Mex service more effectively over the Laredo gateway to enhance the competitive alternative anticipated under the UP/SP merger conditions. Only after Tex Mex and BNSF had reached agreement did KCS intervene in an attempt to block Tex-Mex from entering into this pro-competitive agreement with BNSF.⁵³

KCS did not reveal to BNSF or the Board the basis on which it claimed the right to intervene until BNSF and Tex Mex had already reached agreement. This disclosure did not come until well after the Board's decision in the UP/SP merger to create a competitive alternative to UP at Laredo through BNSF-Tex Mex and KCSR-Tex Mex routings. No immediate resolution was reached. Instead, filings were made before the Board seeking clarification and relief, and only after several months of wrangling with KCS and the Board's indicated willingness to establish a rate, if necessary, were BNSF and Tex Mex able to enter into the agreements. The agreements, by which BNSF and Tex Mex could effectively set and market contract rates, were and are clearly pro-competitive. BNSF's and Tex Mex's attempts to

⁵³ Before the Surface Transportation Board, Finance Docket No. 32760 (Sub-Nos. 26, 30 and 32), BNSF Rebuttal Evidence and Argument in Support of Requests for Additional Remedial Conditions, Verified Statement of Harold F. Weddle, October 16, 1998 (BNSF-10), Tab 2.

complete the agreements indicate that they each thought they were in their own self-interests. Tex Mex, as the bottleneck carrier between BNSF and Laredo, presumably negotiated as successfully as possible to capture the “lump” available to itself (given that it could utilize a competing KCS route to reach U.S. locations). KCS, a minority owner in Tex Mex at that time with no regulatory right of control, exerted itself to prevent this pro-competitive arrangement for BNSF-Tex Mex service to Laredo from taking effect.

The diversion analysis submitted by the Applicants also raises questions about KCS’s post-control intentions with respect to rates and service. A detailed look at the predicted diversions from BNSF to KCS, which amount to almost half (47%) of the revenue estimated to be gained by the combined KCS/Tex Mex, indicates that two-thirds of BNSF’s lost revenue arises from traffic that is diverted from a BNSF interchange with Tex Mex at Robstown or Corpus Christi to an interchange with KCSR at Kansas City.

Half of the revenue the Applicants predict they will gain from BNSF arises from traffic that originates or terminates at stations closed to KCS or at interchange locations that KCS cannot reach. Again, in most cases, the new diverted route is longer than the existing BNSF-Tex Mex route. The portion of the route from Kansas City itself is longer on KCS than on BNSF to any point located on Tex Mex, including Laredo. (See Figure 4.)

Once KCS were to gain control of Tex Mex, traffic that originates on BNSF would still require one interchange with the commonly controlled KCSR-Tex Mex to reach Laredo, whether it interchanges in Kansas City or Robstown. While the diversion study is premised on continued interchange at Robstown and Corpus Christi, it is unclear what changes KCS intends that would force BNSF to interchange traffic at Kansas City rather than Robstown or Corpus Christi. The predicted diversions would be slower and longer, would have the same number of interchanges as the existing route, and would provide a shorter haul for BNSF which originates the traffic. One

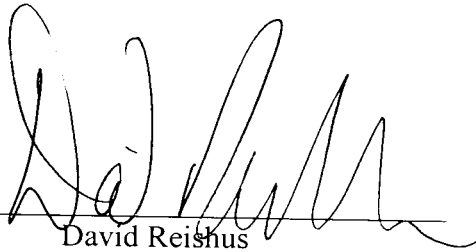
method for achieving that outcome is to raise the divisions at Corpus Christi and Robstown relative to Kansas City so that it is no longer profitable for BNSF to use its more efficient route.

Both past behavior and the projections of the Applicants indicate that modest protective gateway conditions would be prudent public policy to preserve the competitive discipline that a BNSF-Tex Mex routing provides for service to and from Southeast Texas and Mexico.

VERIFICATION

I, David Reishus, verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on August 4, 2003.


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PROFESSIONAL EXPERIENCE

Lexecon Inc., Cambridge, MA
(successor to The Economics Resource Group, Inc.)
Senior Vice President, July 1999 - present

The Economics Resource Group, Inc., Cambridge, MA
President, 1993 - June 1999
Senior Economist, 1990 - 1993

Provides economic analysis and advice on issues of regulation, antitrust, taxation and applied microeconomics to a variety of clients. Develops, manages, and oversees economic analyses for clients and other principals. Responsible for the management and operations of the company.

U.S. Congress, Joint Committee on Taxation, Washington, DC
Economist, 1987 - 1990

Provided economic analysis and development of legislative tax proposals. Responsibilities included corporate and foreign taxation and proposals related to low-income taxpayers, child care, and health issues.

Harvard University, Cambridge, MA
Instructor, 1986 - 1987

Leader of senior thesis tutorial for industrial organization and finance topics. Previously taught Introductory Economics.

Information Resources, Inc., Chicago, IL
Consultant, 1979 - 1980

EDUCATION

Harvard University, Cambridge, MA

Ph.D. in Economics, 1988

Dissertation: "Empirical Essays on the Economics of Taxation and the Firm"

A.M. in Economics, 1983

Northwestern University, Chicago, IL

B.A. in Economics, 1979

TESTIMONY AND OTHER REPORTS

The Burlington Northern and Santa Fe Railway Company

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. Verified Statement, June 3, 2003.

Dynegy Inc.

United States of America, Before the Federal Energy Regulatory Commission, San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, Investigation of Practices of the California ISO and PX; Pub. Utils. Comm'n of the State of California v. Sellers of Long-Term Contracts. Prepared Rebuttal Testimony (with Patrick Wang), March 20, 2003.

Duke Energy Trading and Marketing LLC

United States of America, Before the Federal Energy Regulatory Commission, San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange; Investigation of Practices of the California Independent System Operator and the California Power Exchange. Prepared Rebuttal Testimony (with Patrick Wang), March 20, 2003.

Dynegy Inc.; Duke Energy Services LLC; Mirant Americas, Inc.; Reliant Energy; Williams Energy Marketing and Trading Co.

United States of America, Before the Federal Energy Regulatory Commission, San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange; Investigation of Practices of the California Independent System Operator and the California Power Exchange. Affidavit (with Patrick Wang), October 15, 2002 (revised November 12, 2002), analyzing operation of California natural gas markets during the October 2000 through June 2001 period encompassed by the California Refund Proceeding.

American Association of Railroads

Review of Rail Access and Competition Issues (with Joseph P. Kalt), March 26, 1998, *Before the Surface Transportation Board, Ex Parte No. 575.* Joint Verified Statement evaluating the economic effect of existing regulation on U.S. railroads and analyzing the implications of competitive access regulation.

Large International Petroleum Company

Preliminary Report in Response to an IRS Report (with Joseph P. Kalt), August 8, 1997, and *Preliminary Report Concerning the Value of a Business Opportunity* (with Joseph P. Kalt), September 12, 1997. Reports in connection with IRS internal appeals process.

Crow Tribe of Indians

Report Concerning the Crow Tribe Resort Tax (with Joseph P. Kalt), November 27, 1996; *Surrebuttal Report Concerning the Crow Tribe Resort Tax* (with Joseph P. Kalt), February 25, 1997; and *Report Concerning the Crow Tribe Resort Tax* (with Joseph P. Kalt), March 31, 2000. Reports analyzing the economic relationship of proposed resort tax and tribal spending activities on reservation economy in connection with *Rose vs. Adams* in the Crow Tribal Court, Montana.

Sithe Energies

Economic Impact on New York State of the Sithe Plan, Chapter IV of *Energizing New York: The Sithe Plan*, December 8, 1995. Report analyzing the regional economic impact of electric and gas restructuring proposals.

Massachusetts Department of Environmental Protection

Use of an Economic Test for Distinguishing Legitimate Recycling Activities, July 1993. Report for Department's use in analyzing the licensing of proposed hazardous waste recycling facility.

SELECTED OTHER CONSULTING EXPERIENCE**Amoco**

Analyzed marketability and market value of natural gas for purposes of royalty valuation.

Class 1 Railroad

Analyzed claims of vertical market foreclosure and anticompetitive conduct in rail transportation.

Government of Canada

Assisted in analysis of changes in forestry practices and stumpage charges in the context of international trade agreements.

Exxon Corporation and Affiliated Companies (Miller & Chevalier)

Performed analysis of design and effect of U.K. oil and gas tax system.

CSX Corporation and CSX Transportation, Inc.

Analyzed historical evidence of rail consolidations and the impact of the proposed Conrail transaction on Eastern coal shippers. Evaluated competitive requirements of proposed conditions on the transaction.

Group of Major Oil Companies

Developed and analyzed a database of crude oil purchases for analyzing issues of crude oil valuation at the wellhead.

Koch Pipeline

Assisted in developing product and market definitions relating oil pipeline antitrust allegations.

British Petroleum

Performed economic analysis of alternative organizational forms for operating petroleum assets. Developed advanced financial tools for valuing decision alternatives and contingent assets.

Exxon (McGinnis & Lochridge)

Performed economic analysis of certain fuel used and cost allocations among the Prudhoe Bay Unit owners for a royalty dispute with the State of Alaska.

Burlington Northern Railroad/Santa Fe Railroad (Steptoe & Johnson/Mayer, Brown & Platt)

Analyzed competitive impacts of proposed railroad merger for use before the Interstate Commerce Commission.

Texaco (Thompson & Knight)

Analyzed crude oil pricing in international markets for Internal Revenue Service transfer pricing dispute.

PSI/CINergy

Adapted economic model of regional economy and performed analysis of the economic impact of alternative merger scenarios for a public utility.

El Paso Natural Gas Company (Gibson, Dunn, & Crutcher)

Performed economic analysis of markets and competition for an open-access natural gas pipeline for use in an antitrust case.

Better Home Heat Council, Inc. (Verner, Liipfert, Bernhard, McPherson and Hand)

Performed economic analysis of a local gas utility's conservation programs effect on consumer fuel-switching decisions and public policy impact for use before the Massachusetts Department of Public Utilities.

Association of American Railroads

Analyzed the impact of market conditions for the exemption of rail transportation of export corn and soybeans from Interstate Commerce Commission regulation.

ARCO Pipe Line Company (Steptoe & Johnson)

Evaluation of market power of petroleum products pipeline in consideration of light-handed regulation for use before the Federal Energy Regulatory Commission.

BP/America (Squire, Sanders, and Dempsey)

Assisted in the design and implementation of crude oil valuation analyses for royalty litigation.

Williams Natural Gas Pipeline Co. (Skadden, Arps, Slate, Meagher, & Flom)

Prepared pricing analysis of natural gas purchase contracts, performed calculation of damages, and analyzed economic submissions for use in antitrust case.

El Paso Corporation

Various projects including strategic analysis of market opportunities to enhance value of the pipeline and analysis of market competition in gathering and long-distance gas transportation.

Government of British Columbia (Miller and Chevalier)

Assisted in evaluation of impact of Canadian log export regulations on U.S. and Pacific Rim log and wood products trade and industry.

Atlantic Richfield Company (Arnold & Porter)

Provided economic analysis of market structure and conduct for the distribution of motor fuels for use in an antitrust case.

Burlington-Northern Railroad (Steptoe & Johnson)

Assisted in evaluating market impacts of innovative railroad grain car service rate and reservation policy for use before the Interstate Commerce Commission.

National Cattleman's Association

Researched and wrote report analyzing the welfare and environmental effects of domestic U.S. beef production with particular concern about appropriate policy responses.

PUBLICATIONS AND RESEARCH

"Corporate Reorganizations: Tax Treatment of Corporate Mergers, Acquisitions, and Reorganizations," *The Encyclopedia of Taxation and Tax Policy*, The Urban Institute Press, 1999.

"Outside Directorships, the Reputation of Managers, and Corporate Performance" (with S. Kaplan), *Journal of Financial Economics*, Vol. 27, No. 2, September 1990.

"Financing Child Care: Who Will Pay for the Kids?," *National Tax Journal*, Vol. XLII, No. 3, September, 1989.

"The Effects of Taxation on the Merger Decision" (with A. Auerbach), in A. Auerbach, ed., *Corporate Takeovers: Causes and Consequences*, University of Chicago Press, 1988.

"Taxes and the Merger Decision" (with A. Auerbach), in J. Coffee, L. Lowenstein, and S. Rose-Ackerman, eds., *Knights, Raiders and Targets*, Oxford University Press, 1988.

"The Impact of Taxation on Mergers and Acquisitions" (with A. Auerbach), in A. Auerbach, ed., *Mergers and Acquisitions*, University of Chicago Press, 1988.

OTHER PROFESSIONAL ACTIVITIES

Presentations to National Bureau of Economic Research, Federal Reserve Bank of Cleveland, Federal Reserve Bank of New York, Harvard University, Tax Economists Forum, National Tax Association, Western Economic Association

Memberships in National Tax Association, American Economic Association

Referee for *Quarterly Journal of Economics*, *Journal of Law and Economics*

HONORS AND AWARDS

National Science Foundation Fellowship, 1981-1985

International Foundation of Employee Benefit Plans, Graduate Research Fellowship, 1984

Phi Beta Kappa, 1979

VERIFIED STATEMENT

OF

CURTIS M. GRIMM

I. INTRODUCTION AND SUMMARY

My name is Curtis M. Grimm, and I am Professor and Chair of Transportation, Business and Public Policy, College of Business and Management, University of Maryland at College Park. I have been a member of this College since 1983. I received my B.A. in economics from the University of Wisconsin-Madison in 1975 and my Ph.D. in economics from the University of California-Berkeley in 1983. My Ph.D. dissertation investigated competitive impacts of railroad mergers.

My background includes extensive exposure to public policy issues regarding transportation, including Interstate Commerce Commission ("ICC") merger adjudication. I have previously been employed by the Wisconsin Department of Transportation, the ICC, and the Australian Bureau of Transport and Communication Economics, and I have provided consulting services to several other government agencies and private firms regarding transportation issues. I served as Assistant to the Chief of Intercity Transport Development, Planning Division, Wisconsin Department of Transportation on two separate occasions between 1975 and 1978, with a focus on rail policy issues such as abandonments and the creation of shortline railroads. I also worked on a consolidation involved competing bids from Burlington

provided our company with competitive rates and service. In the near future we would like to begin moving product from various points in the U.S. to Laredo for transfer from rail to truck for delivery into Mexico. This would open up the possibility of backhauling our cars from Laredo to the Eastern U.S. Obviously, we are looking for optimum utilization of our equipment and would like to continue to have several railroads competing for our business. (Cascade Warehouse Company)

Our company plans to extends its reach into Mexico. Within six to twelve months, we plan to begin moving Mexican pine from points within Mexico into the U.S. We believe that the Mexican pine can be marketed in the Midwestern and Southeastern U.S. Although we currently do not ship via rail from Mexico (we have conducted one test shipment via truck), we believe that rail could be a less expensive option versus trucks in this market. (Idaho Timber Corporation)

Much of our traffic moves from warehouse to warehouse and thus is particularly sensitive to transit times. We believe that the logical and economical way to move our business should be on the railroads. (Hudson Foods, Inc.-Turkey Division)

The Mexico market provides great potential for the expansion of Procter and Gamble's products. Again, the reduction in available carriers into and out of Mexico does not fit with this emerging opportunity. We therefore recommend the Surface Transportation Board reject the Union Pacific's acquisition request stated in Docket #32760. (Procter and Gamble)

IV. FOR THE COMMODITIES AT ISSUE HERE, TRUCK AND WATER WILL BE INEFFECTIVE ALTERNATIVES FOR MANY SHIPPERS

Although truck and water play an important role overall in transportation of goods between U.S. and Mexico, many shippers of many commodities are dependent upon rail competition for

competitive transportation options. In his statement, Mr. Ellebracht shows the 23 largest commodities by volume handled by rail through Laredo and the average distance for each commodity shipped between Laredo and the U.S. origin or destination. For the types of commodities involved and the distances involved (which do not even include the Mexican portion of the moves), I fully agree with Mr. Ellebracht that neither truck nor water carriage are alternatives that would provide for most shippers an effective restraint on rail prices in the absence of rail-to-rail competition.

Grain is the most important commodity, and there is well-established evidence as to the ineffectiveness of trucks for the long-haul movements of this commodity, as indicated by the recent Klindworth and Mortinsen report for USDA, cited earlier:

In the United States, semi-tractor trailer combinations are typically used for relatively short-distance movements of bulk grain from the first collection point to processing plants and subterminal and terminal markets. Occasionally, trucks are also used for the movement of grain from nearby producing areas to U.S. ports for export. (p. 29)

Overland truck delivery is a viable alternative for the movement of U.S. grain into Mexico under two general circumstances: (1) where U.S. production areas are near the border and the Mexican demand is composed of a large number of smaller firms without rail service, and (2) where a Mexican grain demand exists immediately across the border and border rail facilities are either not present or are inadequate. (p. 30)

While water is an option for many shippers, that option also has limitations, as noted in the same USDA report:

Between 1990 and 1994 51% of U.S. grain exports to Mexico were via water. This number varies significantly by commodity. Most of this traffic has been via Gulf Ports, although Mexico's Pacific Coast ports have superior vessel draft and natural harbors. (p. 49)

Due to the draft limitations and to the short distances from the U.S. Gulf grain export elevators, the vessels servicing the Mexican Gulf ports tend to be small ...built in the early 1970's or before. Normally, these bulk carriers do not have the efficient discharge gear (cranes) of the later class of larger bulk carriers, and discharge rates for these vessels are low... (p. 51)

Other than the discharge capabilities at port, inland distribution is perhaps the most critical component of moving grain into Mexico via maritime routes. While maritime vessel is generally the lowest cost mode of transporting bulk commodities, the efficiencies of maritime transportation can be lost by the slow discharge at port or by the lack of adequate inland transport capacity. ...especially ...where several ports rely entirely on truck for inland distribution and where the national rail system is capacity-constrained. (p. 56)

Two studies by James M. McDonald contain significant evidence as to the harmful impact on rail rates for agricultural commodities from reduction in rail competition.^{2/} One study, using 1983 data for shipments of corn, soybeans and wheat, performs regressions to ascertain the relationship between rates and rail competition. A second study draws on data from 1981-1985 regarding grain shipments. MacDonald has provided a statement in this case thoroughly and completely rebutting the

^{2/} McDonald, James M., "Competition and Rail Rates for the Shipment of Corn, Soybeans, and Wheat," *Rand Journal of Economics*, Vol. 18, 1987; and McDonald, James M., "Railroad Deregulation, Innovation, and Competition: Effects of the Staggers Act on Grain Transportation," *Journal of Law and Economics*, Vol. 32, April 1989, pp. 63-95.

criticisms of his work by Applicant's witness Willig. His statement includes the following comments:

In his statement, Professor Willig (pp. 570-572) argues that my finding of a strong connection between the Herfindahl index of railroad concentration and railroad prices probably reflects the influence of monopoly: "Of course it might be the case that concentration does matter positively for price, but the finding of the statistical correlation would not reliably prove it, because the correlation would be in evidence just from the monopoly effect, regardless of the behavior of the three to two cases" (p. 571).

However, I specifically considered Professor Willig's question in my 1991 publication (4). The late professor Leonard Weiss asked me to summarize my 1987 article, and add several new bits of information, for the well-known book that he edited, Concentration and Price (MIT Press, 1991). One of the things that Professor Weiss asked me to do was to reestimate my equations without observations from monopoly districts. His letter explained that he wanted to know whether the results were driven by monopoly, or also held as one moved from three to two sellers; that is, he had precisely the same question in mind as Professor Willig. In my article for that book ("Concentration and Railroad Pricing"), I summarize the distribution of estimated Herfindahl indexes and railroad numbers across districts, and report the effects of dropping observations from monopoly districts. I quote from that article (p210): "The regressions were remarkably similar to the old. Coefficient values and significance levels showed hardly any change at all. In particular the coefficients on rail competition in the corn and wheat samples each increased imperceptibly, to $-.283$ in corn and $-.111$ in wheat (or changes of 0.001 and 0.002). The degree of oligopoly appears to matter, as does the transition to monopoly." That article showed that the rail results were not driven by the monopoly results, and that the results of the analysis remain the same, even when we exclude those least competitive markets. (Pages 11-13).

In addition to grain, there are many other commodities involved in U.S.-Mexico rail traffic. My statement for KCS discusses the abundant evidence showing the limitations of truck

and water in competing with rail for many of these commodities. Tex Mex's shippers transport a broad range of commodities, and their statements reflect their dependence on rail to move those commodities. For example:

Eagle Picher is a manufacturer of Diatomaceous Earth products which are primarily used in the filtration, filler, and absorbent markets. We have been a significant railroad customer for nearly 50 years, shipping approximately 1250 cars per year and generating an annual revenue of over \$6,000,000 to the SP and UP combined. (Eagle-Picher Minerals Inc.)

Our company is in the business of exporting U.S. feed grain commodities by rail to Mexico. (Global Grain Co.)

Skill is an advisor to the Kansas Shippers Association which is comprised of the UP-MP, SFE and SSW Shippers Groups. A total of 38 companies are involved in these groups. The individual companies are shippers/receivers of agricultural products, lumber, cement, and plastics. (Skill Transportation Consulting, Inc.)

Badger Mining operates three mines in Wisconsin, which produce silica sand, a specialty sand used in the oil, gas, foundry, glass, abrasive, and water filtration industries. Badger Mining's three Wisconsin mines produce and ship by rail in excess of 600,000 tons of silica sand annually to points throughout the United States, Canada, Mexico, South America, and the Far East. Badger Mining pays more than \$6,000,000 per year in rail freight charges. (Badger Mining Corporation)

L. B. Foster Company manufactures, fabricates and distributes steel pipe and tabular products, railway track rails and trackwork, structural steel, and construction and highway products, with both national and international markets. (L.B. Foster)

I am the Traffic Manager of Kreher Steel Co. and have held that position for the past two years,. I am responsible for the movement of 50,000 net tons of steel bars and billets annually by rail, truck, and water transport. (Kreher Steel Co.)

Faremount Minerals ships via rail to south Texas and Mexico primarily from Wedron (silica sand) and Troy Grove (coated sand), IL. We move the sand to Laredo for export from Wedron via BN-Kansas City-UP and from Troy

Grove via UP direct. We also ship sand to two rail-to-truck transfer points located at Laredo and Alice, TX on the TexMex Railroad. (Fairmount Minerals, Ltd.)

The company's major products are lumber, cedar fencing, trusses, laminates, treated lumber, hardwoods, specialty boards and lumber-related products. These products ship from our ten remanufacturing facilities and from various mills to all states in the contiguous U.S. (Idaho Timber Corporation)

BHP manufactures copper rods and cathode at several facilities in Nevada and Arizona. (BHP Copper Company)

Many of these shippers provide specific details regarding the ineffectiveness of other modes for their particular shipping needs:

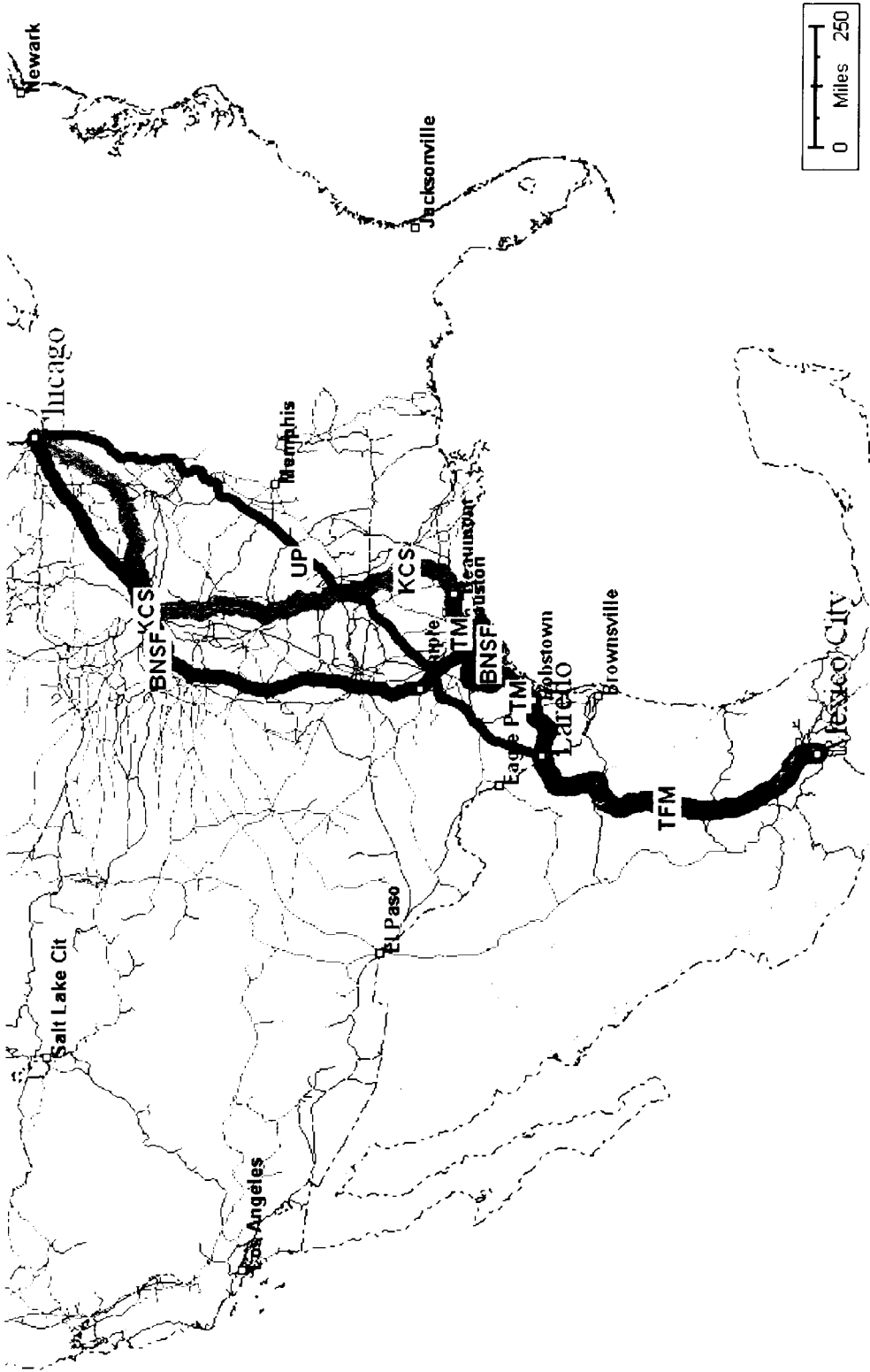
Trucks cannot compete with the railroads for much of our business. We ship bulk loads over a distance that the railroads can handle at a significantly lower cost. Therefore, we cannot depend on truck competition to replace the SP/TexMex on our business moving into Mexico. (Wilbur-Ellis Company)

Fundamental to maintaining and growing business, International Paper Company depends on reliable rail transportation service at competitive prices. Because the distance from many of our facilities to our customers in Mexico exceeds 1,000 miles, rail transportation is the only viable mode of transportation that can be used to competitively place our products in this market. (International Paper Company)

Overall, we find rail shipments to be more cost effective than trucks, especially over long distances. Therefore, trucks are not the best option from a price standpoint for our shipments moving from the Laredo gateway into the U.S. (Cascade Warehouse Company)

V. THE BNSF TRACKAGE RIGHTS WILL NOT BE AN EFFECTIVE ALTERNATIVE FOR THIS LOST COMPETITION.

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