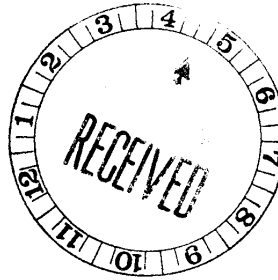


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September 2, 2003

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
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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 Reply Comments of The Burlington Northern and Santa Fe Railway Company (BNSF-5). 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,

A handwritten signature in black ink, appearing to read 'Adrian L. Steel, Jr.' with a stylized flourish at the end.

Adrian L. Steel, Jr.

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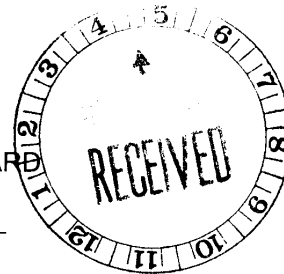
Enclosures

cc: All Parties of Record

208822

BNSF-5

BEFORE THE
SURFACE TRANSPORTATION BOARD



Finance Docket No. 34342

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

REPLY COMMENTS OF
THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

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Dated: September 2, 2003

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 34342

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

REPLY 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 reply comments on the proposed Kansas City Southern ("KCS")/Texas Mexican Railway Company ("Tex Mex") control transaction, including KCS' plan to also acquire Grupo Transportacion Ferroviaria Mexicana, S.A. de C.V. ("TFM") and to combine the railroads under the corporate umbrella of a new NAFTA Rail enterprise.¹

¹ On August 18, 2003, the shareholders of Grupo TMM, S.A. de C.V. ("TMM") voted to not approve the sale of TMM's interests in TFM to KCS. On August 27, 2003, KCS announced that it had received notice from the Mexican Foreign Investment Commission ("FIC") of the FIC's decision to defer KCS' application to acquire control of TFM until after the dispute between KCS and TMM over whether the April 20, 2003 Acquisition Agreement remains in effect is resolved. In so doing, KCS reaffirmed its position that the Acquisition Agreement is valid and effective and is binding on the parties and that it intends to proceed with its acquisition of TFM. Further, TMM has recently sent a demand to KCS under the parties' agreements to repurchase the shares (cont'd)

INTRODUCTION AND SUMMARY

As stated in BNSF's comments submitted on August 4, 2003, BNSF supports the KCS/Tex Mex/NAFTA Rail transactions subject to clarification of the pledges and commitments made by KCS and to their inclusion as conditions in the Surface Transportation Board's final decision. BNSF supplements its original comments to respond to recent developments and to provide greater clarification as to the conditions that are necessary to ensure that the benefits of the proposed transaction are realized by the shipping public and that existing competition for rail traffic moving to and from south Texas and Mexico markets served by Tex Mex and TFM is fully preserved.

Since August 4 when BNSF submitted its comments, BNSF has had an opportunity to review the August 1, 2003 agreement between KCS and The National Industrial Transportation League ("NIT League"), as well as KCS and NIT League's letter provided in response to the request for clarification made by Union Pacific Railroad Company ("UP"). As previously indicated, BNSF's interests in this proceeding are to ensure that customers relying on BNSF to access markets and customers in south Texas on Tex Mex and in Mexico on TFM are not impeded from doing so as a

(... cont'd)

of Mexrail, Inc. (the parent of Tex Mex) which KCS purchased in May 2003. As of the filing of these reply comments, KCS has not publicly responded to TMM's demand. BNSF is submitting these reply comments on the assumption that the KCS/TFM transaction will eventually be consummated as set forth in the Application and that KCS' acquisition of Tex Mex will not be reversed. In the event that either or both of those assumptions are incorrect or if the terms and conditions of either transaction change, BNSF will, as appropriate, request leave to submit further comments.

result of these transactions, and that BNSF continues to fulfill its obligations resulting from agreements and conditions in the UP/SP merger.

BNSF's review of the KCS/NIT League Agreement has identified a number of issues in the Agreement impacting the interests of shippers relying on BNSF to reach customers and markets on Tex Mex and TFM which should be addressed by the Board. Specifically, the KCS/NIT League Agreement (1) does not require NAFTA Rail to maintain commercially reasonable rates with respect to traffic interchanged between U.S. carriers and TFM, (2) does not define "commercially reasonable" rates, including interline divisions of rates, (3) does not address rate agreements between TFM and other carriers or marketing, operational and service agreements between KCS, Tex Mex and/or TFM and other carriers, (4) does not require the NAFTA Rail carriers to provide neutral, non-discriminatory service both at Laredo and Brownsville and over their lines, and (5) does not require formal Board oversight of the transaction. Each of the issues should be addressed through amendments to the KCS/NIT League Agreement and/or conditions to the Board's approval of the proposed transaction.

In addition to these amendments and/or conditions, the Board should also require NAFTA Rail to abide by the terms of the several pledges and commitments that it has made in an effort to induce shippers and other industry participants to support its transaction. Notably, NAFTA Rail has committed on numerous occasions to (1) keep gateways open on commercially reasonable terms, (2) continue to work with UP and BNSF to provide the same level of interline service as received in the past, (3) honor terms of all marketing and pricing agreements for their entire remaining term, not canceling such agreements early, even if able to do so, and (4) abide by all existing

agreements governing operations over the Laredo Bridge. These commitments should be further defined as discussed below, and KCS should be required by the Board to fully adhere to and honor the commitments for the components of the NAFTA Rail network, Tex Mex and TFM, it is acquiring.

Finally, the Board should impose a temporary transitional period during which time the Board should retain jurisdiction over the transaction, and NAFTA Rail should be required to maintain its current pricing levels for traffic moving via Laredo and Brownsville subject to modification based on increases in the Unadjusted Rail Cost Adjustment Factor ("RCAF-U"). Such a transition period is a reasonable accommodation to preserve interline competition and shippers' options. It allows connecting carriers time to negotiate interline agreements or provide for reasonable alternative solutions if such agreements cannot be reached, and it allows shippers time to adjust their logistics plans to account for any changes in shipping routes, service patterns, or carriers. Moreover, such a transition period can also help to maintain stability in what is likely to be a complicated merger integration. The uncertainty of that integration was underscored by the recent announcement by TMM that its shareholders have rejected the proposed KCS/TFM transaction, by the FIC's deferral of its decision on that transaction, and by TMM's announcement that it will exercise its right to repurchase shares representing an aggregate 51 percent in Mexrail that were sold to KCS in May 2003, and which form the basis for this control proceeding. While KCS maintains that it will enforce its rights under the parties' contract, it appears that any integration planning prior to execution of the transaction could be overshadowed by efforts to resolve differences between the partners and move forward with the proposed

transactions, creating the potential for service disruptions upon closure and implementation. The implementation of a temporary transition period will help stabilize the overall service environment and will permit market forces, rather than short-term market power, to mold the relationship between NAFTA Rail and other carriers and shippers.

I. THE PROVISIONS OF THE KCS/NIT LEAGUE AGREEMENT SHOULD BE SUPPLEMENTED IN ORDER TO ENSURE THAT COMPETITION IS PRESERVED

On August 1, 2003, KCS and NIT League entered into an agreement which addressed several of the competitive concerns raised by other parties to this proceeding. The KCS/NIT League Agreement was apparently executed in an attempt by KCS to fulfill the pledge it has made in its written submissions to the Board, as well as at the Board's July 31, 2003 public hearing, to keep the Laredo and Brownsville gateways open on commercially reasonable terms. However, as set forth below, there are a number of areas in which the KCS/NIT League Agreement falls short of that pledge,² and the Board should impose as a condition on its approval of the KCS/Tex

² Indeed, NIT League itself acknowledged in its August 4, 2003 pleading submitting the Agreement (NITL-3) that not all competitive concerns raised by the proposed NAFTA Rail transactions are addressed by the Agreement. See NITL-3 at 5 ("[T]he agreement also addresses some of the transnational effects of the broader transaction") (emphasis added). Further, it is worth noting that the protections provided in the KCS/NIT League Agreement are in a number of respects less than those provided in a previous agreement entered into by NIT League with Canadian National Railway Company in *Canadian National Ry. Co. – Control – Wisconsin Central Transp. Corp.*, STB Finance Docket No. 34000, Decision No. 10 (served September 7, 2001) ("CN/WC"), at 12-14. There, the agreement was applicable to all active gateways (unlike here, where Laredo and Brownsville are not fully covered). The agreement also provided for a transitional five-year limit on increases on through rates (subject to RCAF-U). No such transitional limit on increases is contained in the KCS/NIT League Agreement, despite the significantly larger potential competitive impact of the proposed
(cont'd)

Mex transaction the following additional protections to ensure that the gateways are in fact kept meaningfully open so that existing competition which customers rely on to access markets in south Texas and Mexico is preserved.³

First, as reflected in their August 18, 2003 letter to David L. Meyer, UP's counsel in this proceeding,⁴ KCS and NIT League have clarified that their Agreement "will not require NAFTA Rail to establish and maintain commercially reasonable contract or common carrier rates and charges with respect to traffic interchanged between UP and TFM at the Laredo Gateway." August 18 Letter at 1. Although not explicitly stated, it can be assumed from that statement that this would also mean that NAFTA Rail would similarly have no obligation under the Agreement to establish and maintain commercially reasonable contract or common carrier rates and charges with respect to traffic interchanged between TFM and UP or BNSF at the Brownsville gateway. However, as David Reishus establishes in his Reply Verified Statement ("Reishus Reply

(... cont'd)

transaction. The level of service protection was also more substantial in the CN/NIT League agreement.

³ These additional protections could be imposed as independent conditions on the Board's approval of the transaction or, as it has done in the past with settlement agreements in other control proceedings that it found were lacking, the Board could require the Applicants to amend the NIT League Agreement to incorporate the additional protections. See *Union Pacific Corp. – Control and Merger – Southern Pacific Rail Corp.*, 1 STB 233, 419-20 (1996) ("UP/SP").

⁴ KCS' and NIT League's August 18 letter (NITL-4/KCS-17) was in response to Mr. Meyer's August 8, 2003 letter in which, on behalf of UP, he requested clarification of a number of aspects of the KCS/NIT League Agreement. While the August 18 letter has provided clarifications as to a number of issues, it has also identified, as discussed in the text above, a number of other issues in the KCS/NIT League Agreement that need to be addressed.

V.S.”) submitted herewith, unless NAFTA Rail is required to establish and maintain commercially reasonable rates and charges for movements in Mexico and the obligations of the Agreement apply to TFM (once KCS acquires control of the carrier), then there can be no assurance that competition will be preserved and that the gateways will be kept open as KCS has pledged. For instance, the commercially reasonable rates and charges that NAFTA Rail charges in the United States for traffic moving over KCS and/or Tex Mex can be undercut and the competitive alternatives provided by UP and BNSF routings negated by the simple expedient of NAFTA Rail’s TFM component imposing rates and charges for the Mexican portion of traffic movements where pricing breaks at the border that would price the BNSF and UP interline routings out of the market.⁵

Second, the KCS/NIT League Agreement does not provide a specific definition of the term “commercially reasonable” rates. Absent further clarification of what is meant

⁵ In this regard, it should be noted that, according to KCS’ and NIT League’s letter, the Agreement would apply to TFM rates and charges to the extent that those rates and charges were part of a *through* rate between points in the United States and Mexico if Tex Mex or KCS interchanged the traffic with UP or BNSF in the United States. August 18 Letter at 1. Accordingly, since KCS is willing to exercise control over TFM to require commercially reasonable rates and charges as part of a through rate, KCS should have no principled objection to exercising control when the rates and charges apply to traffic between a border gateway and a point in Mexico as a separate movement. In fact, KCS’ President and Chief Executive Officer, Michael R. Haverly, has himself previously expressly committed to maintaining commercially reasonable rates and charges on both Tex Mex and TFM without qualification. Transcript of July 31, 2003 Public Hearing on Proposed “KCS-Tex Mex” Railroad Merger, at 22. KCS and NIT League have provided no reason in their pleadings or in their August 18 letter as to the basis for this distinction, and the Board should require that it be eliminated so that commercially reasonable rates and charges can be assured for all traffic moving through these critical Mexican gateways.

by the term,⁶ there will be a potential for KCS and the other NAFTA Rail carriers to take advantage of the ambiguity and to hinder BNSF's and UP's ability to continue to compete, and "[t]here is no assurance that 'commercially reasonable' as determined by the Agreement would permit economically efficient outcomes or effective competitive discipline by BNSF." Reishus Reply V.S. at 8. Accordingly, further definition of the term is required, and it should be helpful to NAFTA Rail, connecting carriers and ultimately the rail customers whose traffic is currently or could potentially be moving over three rail networks, because it will reduce or eliminate disputes in the future. BNSF submits that "commercially reasonable" rates and charges should permit BNSF and UP to continue to compete for traffic as to which they can provide rail customers equally or more efficient service than can be provided by the NAFTA Rail carriers. Otherwise, NAFTA Rail will have the ability through the exercise of the market power it gains through the common control of Tex Mex and TFM to force shippers to accept less efficient and more costly routings.

⁶ In their August 18 letter, KCS and NIT League responded to a request from UP to provide further clarification as to the meaning of "commercially reasonable" in the context of the KCS/NIT League Agreement. However, their response simply stated that the meaning of the term "would be determined by the parties to the process of establishing and maintaining the rates and charges to the shipper as a whole (not to individual railroad divisions or rate factors)." August 18 Letter at 2. This attempted clarification (which is itself unclear as to its meaning) does nothing to resolve the ambiguity, and more specific guidance is required so that the parties and, if needed, an arbitrator will be aware of the appropriate standards to be applied. Moreover, as Dr. Reishus notes in his Reply Verified Statement, the language in the letter leaves open the possibility that the "commercially reasonable" obligation may not apply to the division demanded by the NAFTA Rail entities, but to the through rate that shippers pay for the joint-line movement. Reishus Reply V.S. at 8. As he states, "[u]nreasonable or inefficient division requirements by NAFTA Rail could prevent BNSF from competing for traffic even when it was the most efficient upstream carrier." *Id.* at 9.

Third, Section 2(b) of the KCS/NIT League Agreement commits KCS and Tex Mex to honor their existing rate agreements with other U.S. carriers until their normal expiration date and, when they expire, to negotiate in good faith to establish commercially reasonable rates going forward. The language does not, however, mention whether existing agreements between TFM and other carriers would similarly be honored and replacement agreements negotiated in good faith. Further, the present language only addresses existing rate agreements, and similar protection is needed for existing marketing, operational and service agreements between KCS, Tex Mex and TFM and other carriers. Absent such broader reach, NAFTA Rail would again be able to exercise its common control of Tex Mex and TFM to its competitive advantage and to the disadvantage of shippers.

Fourth, while Section 4 of the KCS/NIT League Agreement provides that KCS and NAFTA Rail will maintain and strive to improve service levels between Beaumont and Laredo, the Agreement does not otherwise address the level of service that the NAFTA Rail carriers will commit to provide interline connections (BNSF and UP) at Laredo and Brownsville as well as over their lines between Robstown/Corpus Christi and Laredo, which are of overriding importance to BNSF and BNSF's customers. Elsewhere, the NAFTA Rail carriers have pledged to continue to work with UP, BNSF and other carriers on, among other things, pre-blocking rail cars, improving automatic customer pre-clearance procedures, supplying cars for shipments, accommodating run-through train service, promptly quoting rates, and otherwise providing "excellent service." See June 23, 2003 Supplement to Application (KCS-10/TM-10), Verified Statement of Gerald K. Davies ("Davies V.S.") at 14. Because the continued provision

of neutral, non-discriminatory service by Tex Mex and TFM is critical to the preservation of effective competition to and from Mexico, the KCS/NIT League Agreement should be amended to require the NAFTA Rail carriers to provide such interline service at least at the service levels that are currently being provided, assuming the shippers' transit requirements including velocity and consistency of service, and interline volumes, do not appreciably change.

Finally, NIT League has requested that the KCS/NIT League Agreement be imposed as a condition to the Board's approval of the proposed KCS/Tex Mex transaction. NITL-3 at 5-6. However, the Agreement does not expressly provide for a period of oversight by the Board — notwithstanding the fact that there are a number of critical issues on which the Applicants' good faith adherence to the terms of the Agreement and any additional conditions the Board may impose will be essential to maintaining full and effective competition over the Mexican gateways. The Board has imposed oversight periods on prior control transactions with the similar potential to affect competition and service, and it should do likewise here either directly by imposing a condition itself or by requiring the KCS/NIT League Agreement to be amended to provide for such oversight.

II. KCS SHOULD BE REQUIRED TO ADHERE TO THE PLEDGES AND COMMITMENTS MADE IN ITS PLEADINGS TO THE BOARD

In addition to the commitments that KCS made in its agreement with NIT League, KCS has made additional pledges and commitments in its submissions to the Board. Specifically, KCS has committed to "keep the Laredo gateway open on commercially reasonable terms," to "continue to work with both UP and BNSF," to "honor the terms of all marketing and pricing agreements involving Tex Mex and TFM," and to "abide by all

existing agreements governing operations over the Laredo Bridge.” These pledges have likely influenced shippers’ reaction – and muted their opposition or requests for further clarification – to the proposed transaction, and KCS has used those pledges to blunt the concerns which have been raised by carriers and other interested parties to this transaction. Those pledges need to be clearly stated and understood by shippers and connecting carriers, and KCS should be held to its pledges and commitments. Requiring it to do so is consistent with past Board practice, creates no hardship for the Applicants, and ensures that shippers do not misunderstand and are not misled by vague promises on the part of the Applicants.

A. Pledge To Keep Gateways Open On Commercially Reasonable Terms

KCS has committed to keep the Laredo and Brownsville gateways open on commercially reasonable terms. July 31, 2003 Hearing Transcript at 168, 173. KCS has stated that this commitment “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 15.⁷ Consistent with that pledge, KCS has also committed to treating the BNSF/TFM interchange at Brownsville “[t]he same that we would treat them at Robstown, that the Gateway would remain open, and we would treat them fairly, just like we believe that they’ve been treated now.” July 31, 2003 Hearing Transcript at 23.

To provide meaning to these statements, BNSF suggests that maintaining an open gateway on commercially reasonable terms must mean that KCS will price its

⁷ As noted earlier, the CN/NIT League agreement required that *all* active gateways would remain open, and also provided for a five-year limit on increases on through rates (subject to RCAF-U).

rates to its connections interchanging with both or either Tex Mex or TFM at a level that allows the connections to compete for shippers' traffic on all routes where they are equally or more efficient than NAFTA Rail. Such a definition would permit NAFTA Rail to capture the efficiencies of its proposed transaction, while also providing some limitation on NAFTA Rail's discretion so that shippers are afforded competitive pricing and service when relying on carriers other than those comprising the NAFTA Rail network. Thus, the Board should require NAFTA Rail to maintain the Laredo, Brownsville and Robstown gateways open on commercially reasonable terms, which would require that interline connecting carriers receive rates at a level that allows those carriers to compete for traffic to be interchanged with the components of NAFTA Rail on all routes where they are equally or more efficient than KCS-Tex Mex-TFM. See Reishus Reply V.S. at 8-9.

B. Pledge To Continue To Work With Both UP And BNSF

The Applicants should also be required to adhere to their pledge to "continue to work with both UP and BNSF." June 23, 2003 Supplement to Application, at 24. Indeed, KCS has committed to "provide the same level of service to UP and BNSF as they have experienced in the past" (Davies V.S. at 15), and it has stated that "TFM will continue to cooperate with UP and BNSF regarding pre-blocking rail cars, automated customers pre-clearance procedures, supplying cars, accommodating run-through train service, and promptly providing rate quotes for UP and BNSF customers." June 23, 2003 Supplement to Application, at 25.

While these commitments are helpful, there are numerous other services that are not listed. Rather than identify prospectively all services that the Applicants should continue to provide, the control transaction should be conditioned on NAFTA Rail

providing all services to connecting carriers as Tex Mex and TFM have provided in the past at the same level, unless cancelled or changed through mutual agreement. See Reishus Reply V.S. at 9.

C. Pledge To Honor Terms Of All Marketing And Pricing Agreements

The Applicants have pledged to “honor the terms of all marketing and pricing agreements involving Tex Mex and TFM,” and “[t]o not cancel any existing agreements, even if it has the legal right to do so, until the end of the term of such an agreement.” June 23, 2003 Supplement to Application, at 26 and 24, respectively. Such a pledge has little meaning in the context of BNSF’s relationship with Tex Mex and NAFTA Rail if it does not also include a provision to renegotiate in good faith and on a timely basis the terms of those existing agreements, ultimately permitting shippers relying on BNSF and those agreements’ terms to access customers and markets in south Texas and Mexico. The Robstown-Laredo interline divisions agreement for most commodities between BNSF and Tex Mex is scheduled for expiration at the end of 2003 unless renewed or superseded, and, despite the numerous opportunities for renegotiation that this proceeding has provided, to date there are no substantial proposals from Tex Mex or KCS on potential renewal terms. During the July 31 hearing, KCS stated that “[w]e’ve committed before and we commit again to negotiate seriously with BNSF when that contract expires.” Statement of Mr. Davies at July 31, 2003 Hearing Transcript, at 166.

While serious negotiations would be a good start, the proposed transaction, if approved, should be conditioned on NAFTA Rail continuing the current rates with appropriate escalation as BNSF proposes to ensure rail customers are not in doubt about the level of rail rates they will be asked to accept from BNSF to access south

Texas and Mexico markets and customers, and entering into good faith negotiations for renewal of those agreements. In addition, literally waiting for the existing interline divisional agreements to expire before negotiating for either an extension of those interline agreements or their replacement is simply too late for BNSF to provide competitive interline service offerings to its connections and customers to reach Tex Mex and TFM markets and customers.

KCS suggests that negotiation of renewal rates should be left to the parties because “[t]he rates that are there today were negotiated between two railroads, and the replacement rates should be negotiated when that contract comes due.” July 31, 2003 Hearing Transcript, at 165-66. As the Board is aware, BNSF and Tex Mex had negotiated a set of commercial agreements in early 1998 by which BNSF could more effectively market BNSF-Tex Mex interline service over the Laredo gateway. Despite the fact that both BNSF and Tex Mex believed the agreements were in their own self-interests, KCS, a minority owner in Tex Mex at the time, intervened to thwart those negotiations. Only after filings were made to the Board and several months of negotiations were BNSF and Tex Mex able to neutralize the objections of KCS through a closer working relationship by BNSF directly with TFM. The modest condition that NAFTA Rail negotiate the renewal of the BNSF-Tex Mex agreement in good faith could not be objectionable to the Applicants unless they intend to conduct their contract negotiations in something other than good faith, and the imposition of that condition on the proposed transaction will ensure that shippers and carriers are not held hostage to NAFTA Rail’s new market power resulting from the proposed transaction.

D. Pledge To Abide By All Existing Agreements Governing Operations Over The Laredo Bridge

KCS has pledged “to abide by all existing agreements governing operations over the Laredo Bridge.” June 23, 2003 Supplement to Application, at 24. The Applicants have further committed “to abide by the existing dispatching and operating practices over the bridge that exist today.” Davies V.S. at 16. Like its other commitments, this commitment should be entered as a formal condition to the approval of the proposed transaction. While BNSF traffic will cross the International Bridge at Laredo in trains physically moving between Tex Mex and TFM, it is important that BNSF traffic continue to move across the U.S.-Mexican border on as timely a basis as similar traffic moving in conjunction with either KCS or UP.

* * * * *

The Applicants have offered these commitments as necessary inducements to shippers to gain their support for the proposed transaction, and they have used the existence of those commitments as a response to the legitimate concerns raised by shippers and other carriers before this Board. At a minimum, the Applicants should be required to abide by the terms of those commitments. *See, e.g., CN/WC* at 12 (“We will . . . hold applicants to representations they have made in this record about the meaning and reach of the NITL/CN Agreement”); *Canadian National Railway – Control – Illinois Central Corp.*, STB Finance Docket No. 33556, Decision No. 37 (served May 25, 1999) at 57 (“Applicants must adhere to all of the representations they made on the record during the course of this proceeding”). Thus, imposition of those commitments as conditions to the approval of the proposed transaction cannot unfairly prejudice the Applicants, and it will provide protection to shippers and other carriers to ensure that the

benefits of the proposed transaction will not be outweighed by the potential loss to competition that might occur in the absence of those conditions.

III. THE BOARD SHOULD IMPOSE A TEMPORARY TRANSITION PERIOD WITH BOARD OVERSIGHT AND MAINTENANCE OF EXISTING GATEWAY RATES AND CONDITIONS

In addition to conditioning approval on NAFTA Rail's adherence to its own commitments, the Board should also impose a temporary transition period in the range of three to five years to ensure that there are no significant market dislocations while NAFTA Rail is implementing its multi-faceted control transaction in the U.S. and Mexico. That transition mechanism would have two components. First, as discussed above, the Board should retain oversight authority during that time period to address any issues that arise and ensure that there is no adverse impact to competition during that time. Such oversight authority is common for major control transaction such as this one. See, *e.g.*, *UP/SP; CN/IC*. Second, during the transition period, NAFTA Rail should maintain existing divisions and rates at its gateways, except for increases no greater than increases in the RCAF-U. Such a condition was implemented in the *CN/WC* transaction, and has not impacted the carriers' ability to capture the benefits of that transaction, nor been the subject of subsequent shippers' complaints, challenges, or requests for additional clarification.

As detailed below, imposition of such a transition period will have several advantages. First, it will allow shippers time to alter their logistics requirements around potentially new and changing shipping patterns and terms. Second, the transition period will provide a measure of stability while NAFTA Rail integrates the railroads into a single network. This latter benefit is particularly important in the present case, where three rail lines in two countries will be combined, where the transaction is impacted by

differing regulatory environments, where the transaction will require a challenging integration of IT infrastructure, and where two of the parties to the proposed transaction may be involved in litigation until the transaction closes if it does at all. Finally, it would ensure NAFTA Rail that the interline rate components used in the future, unless otherwise agreed to, would at least be at the same level as the interline rates existing presently. Such a condition is consistent with past practices of the Board and should not diminish the efficiency gains from the merger or otherwise negatively impact NAFTA Rail. See Reishus Reply V.S. at 10-13.

A transition period provides a reasonable public policy accommodation to preserve competition and shipper options. First, such a transition period will provide shippers time to adjust their logistics requirements to accommodate changes in shipping options. For example, where KCS diverts shippers to KCS' routes from competitors' routes, shippers may need to adjust their inventory management and other systems to account for the assuredly different shipping times involved in using a route including KCS. See August 4, 2003 BNSF Comments, Verified Statement of Peter J. Rickershauser at 21-22. Further, where shippers continue to use NAFTA Rail's competitors, those shippers may have to adjust to changes in routings that those competitors make as a result of the proposed transaction. If rates and service terms were not to be maintained during that transition period, shippers may be forced into inefficient service arrangements or may make hasty changes to their logistics plans to maintain supply chains to their customers. When magnified across thousands of shippers with transportation to and from south Texas and Mexico, such an abrupt shift

in transportation costs or terms could magnify any other service problems resulting from the transition.

Second, the provision of a temporary transition period would facilitate the smooth implementation of negotiated interline and other agreements between carriers, the absence of which would harm shippers. For example, the current interline divisions agreement covering most commodities between BNSF and Tex Mex will expire in December of this year. To date, there are no significant discussions between the parties as to the terms for the renewal of that agreement, despite several proposals from BNSF. When the existing agreement was negotiated in 1998, it took nearly a year and filings at the Board for the parties to reach agreement. In the present context, absent a transition period, shippers with traffic over BNSF to Mexico could face substantial disruptions to their traffic flow if BNSF were forced to carry their traffic over less efficient alternative routes.

Providing a transition period to smooth NAFTA Rail's implementation of its control transaction will be particularly important in this case. As the Board has recognized, "serious transitional service problems . . . have accompanied recent major rail consolidations." STB Ex Parte No. 582 (Sub-No.1).⁸ In addition to the normal integration difficulties faced by railroad mergers within the United States, this proposed transaction is particularly susceptible to transitional uncertainty over the near term. First, because NAFTA Rail will be subject to differing regulatory requirements on each side of the U.S.-Mexico border, it will take NAFTA Rail and shippers some time to

⁸ *Major Rail Consolidation Procedures* (served June 11, 2001).

understand their rights and responsibilities under those regulations and to establish commercial pricing arrangements that reflect that environment. Second, because the proposed transaction involves the combination of three railroads in two countries, the normal integration problems – IT infrastructure decisions, reallocation of decision-making responsibility, standardization of operating parameters, etc. – will be magnified. Third, the recent vote by TMM's shareholders against the proposed KCS/TFM transaction will make any pre-closing transition planning difficult, as there will be little cooperation in the near term between KCS and TFM about consummating a series of agreements one of the parties, TMM, now desires to cancel. Thus, the initial period of operation after KCS closes on the transaction (assuming it does close on the transaction) may be chaotic. Fourth, as Pacer International has pointed out, NAFTA Rail also faces a challenging IT integration of KCS' operating system, MCS, on Tex Mex and TFM, which will take some time to implement and for which NAFTA Rail has provided no plans. See August 4, 2003 Comments of Pacer International, Inc. (PI-4).

Shippers, such as Pacer, necessarily take such operational issues into account in reaching any agreement on rates and overall service packages, and the ambiguity created by these factors will make pricing decisions challenging at best, as shippers will have minimal confidence in the service levels that they would receive along with their rates. In that context, a temporary transition period that maintains rates at existing levels (subject to RCAF-U increases) will provide a reasonable accommodation to shippers and will help stabilize one variable in NAFTA Rail's overall integration.

A temporary transition period was used successfully in the *CN/WC* transaction approved by the Board in 2001. In that case, applicants pledged that for five years they

would not increase their portion of through rates that were in effect on the date of consummation of the transaction, except to take increases no greater than the change in certain indices of railroad costs. *See, e.g., CN/WC*, at 34. There is no evidence that the existence of that five-year transition period has diminished the efficiency gains that the *CN/WC* merger generated, nor did it deter the parties from completing their transactions and capturing those gains. Nor has KCS offered any other reason why a transition period would be detrimental to its integration efforts.

CONCLUSION

For the reasons set forth above, BNSF respectfully submits that, should the Board find 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 that the KCS/NIT League Agreement be amended as set forth above, by requiring that KCS fully honor and adhere to the pledges and commitments that it has made, and by imposing a transition period during which (i) the Board would retain oversight authority to address any issues that arise and ensure that there is no adverse impact on competition; and (ii) the Applicants would be required to maintain the existing Tex Mex and TFM rates and services presently available for service in

conjunction with BNSF, subject to RCAF-U increases, and to provide commercially reasonable rates and services thereafter subject to the jurisdiction of the Board.

Respectfully submitted,



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Dated: September 2, 2003

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

FINANCE DOCKET NO. 34342

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

**REPLY 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, I was President of The Economics Resource Group, Inc. I received my Ph.D. and Master's degrees in economics from Harvard University. 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 verified statements previously submitted in this proceeding.¹

On behalf of The Burlington Northern and Santa Fe Railway Company ("BNSF"), I analyze further here the competitive issues of the proposed common control of The Texas Mexican Railway Company ("Tex Mex") and

¹ Finance Docket No. 34342, The Burlington Northern and Santa Fe Railway Company's Reply to Applicants' Petition to Establish Procedural Schedule, Verified Statement of David Reishus, June 3, 2003, and Comments of The Burlington Northern and Santa Fe Railway Company, Verified Statement of David Reishus, August 4, 2003 ("Reishus V.S").

The Kansas City Southern Railway Company ("KCSR") by Kansas City Southern ("KCS")² in light of the testimony, filings, and new information provided by KCS and other parties.

I.B. Summary

Laredo is the preeminent gateway for rail traffic between the U.S. and Mexico. Union Pacific ("UP") handles most of the rail traffic on the U.S. side of the Laredo gateway. BNSF was provided access to Tex Mex as a condition of the UP/Southern Pacific Rail Corporation ("SP") merger so that a BNSF-Tex Mex routing competitively disciplines UP's rates and services. Tex Mex also received trackage rights to Beaumont in order to connect with KCSR. TFM, S.A. de C.V. ("TFM") is the only railroad serving the Laredo gateway on the Mexican side.

KCS control of Tex Mex (and its further anticipated control of TFM)³ dramatically alters the competitive options through the Laredo gateway. Preservation of shippers' competitive alternatives imposed in the UP/SP merger requires that BNSF have continued viable economic and physical access via interchanges with Tex Mex connecting to TFM at Laredo, and with TFM at Brownsville. This means that the proposed NAFTA Rail must

² Finance Docket No. 34342, Railroad Control Application, May 14, 2003 ("KCS Application"); Finance Docket No. 34342, Supplement to Application, June 23, 2003 ("Supplemental Application"). 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."

³ While the current shareholders of Grupo TMM, S.A., which controls TFM, have recently voted to reject the transaction with KCS, KCS maintains that it has a binding agreement and intends to consummate the transaction. Letter from John F. Marvin to Kenneth A. Ostrow, August 21, 2003, Kansas City Southern, Form 8-K, Exh. 99.1, August 21, 2003. Grupo TMM also announced that it intends to have TFM repurchase the majority ownership of Mexrail (which owns Tex Mex) that has been held in a voting trust by KCS. "Grupo TMM Announces Repurchase by TFM of Stake in Mexrail: Exercise of Repurchase Right Returns 100 Percent Mexrail's Interest to TFM," <http://www.grupotmm.com/esp/english/news/newsx/030828repurtfmmex.htm>, August 28, 2003. For purposes of this analysis, I assume that the transaction with TFM will still be consummated and the ownership interest in Tex Mex will not be repurchased by TFM.

maintain open interchanges, both physically and economically, at Robstown (between BNSF and Tex Mex) and at Laredo and Brownsville (with TFM).

In its Supplemental Application, KCS “commit[ted] that it will keep the Laredo gateway open on commercially reasonable terms.”⁴ At the Public Hearing, KCS’ CEO committed to maintaining reasonable rates and charges on both Tex Mex and TFM.⁵ Further, The National Industrial Transportation League (“NIT League”) reached an agreement with KCS (“NIT League Agreement” or “Agreement”), which NIT League requested be imposed as a condition on the transaction. The Agreement requires that KCS “maintain commercially reasonable contract or common carrier rates” under certain circumstances.⁶ While these KCS commitments and the NIT League Agreement represent a partial start to preserving shippers’ competitive options, limitations and uncertainties in the Agreement and KCS commitments call for additional clarification and conditions to preserve competition.

Sound competition and regulatory policy calls for the Surface Transportation Board (“STB” or “Board”) to retain post-merger oversight of pro-competitive open gateway commitments. Moreover, clarification by the Board of these commitments will benefit shippers through the retention of competitively efficient rates and service. Specifically, the scope of KCS’ commitments, the enforcement of the commitments, and the meaning of “commercially reasonable” must be clarified. Finally, a temporary transition rule under which increases to existing competitive rates are limited provides a backstop to any commercial negotiations among shippers and carriers, and

⁴ Supplemental Application, Verified Statement of Gerald K. Davies, at 15.

⁵ Michael R. Haverty, Transcript of Public Hearing on Proposed “KCS-Tex Mex” Railroad Merger, July 31, 2003 at 22.

⁶ Agreement between The National Industrial Transportation League and Kansas City Southern, August 1, 2003, attached to Finance Docket No. 34342, Comments and Statement of Support on behalf of The National Industrial Transportation League, August 4, 2003.

would avoid disruption of existing competitive alternatives due to the common control of the separate carriers under NAFTA Rail.

II. PRESERVATION OF COMPETITIVE DISCIPLINE

Laredo is widely recognized as one of the most significant gateways in the North American rail network, since a majority of U.S.-Mexico rail traffic interchanges through this gateway. Tex Mex's unique significance results from its being the only railroad with physical U.S. access to the Laredo gateway besides UP. As a condition of the UP/SP merger, BNSF was granted access to Tex Mex at Robstown (and Corpus Christi) as a competitive replacement to SP. In addition, Tex Mex was provided trackage rights to Beaumont to connect with KCSR. BNSF-Tex Mex routings provide competitive discipline to UP for rail traffic to and from Mexico through the Laredo gateway.⁷ KCSR-Tex Mex routings also provide competition to UP, although the BNSF rail network more closely matches that of UP than does the KCS network.

TFM is the most important Mexican railroad for U.S.-Mexican trade and has exclusive access on the Mexican side of both Laredo and Brownsville.

Control of Tex Mex by KCS gives KCS the opportunity to inefficiently foreclose BNSF from access to the Laredo gateway and diminish the competitive discipline that BNSF-Tex Mex provides. Control of TFM by the combined Tex Mex-KCSR would give KCS the further opportunity to inefficiently foreclose traffic on both BNSF and UP at Laredo and Brownsville. To the extent that competition is foreclosed through KCS control of Tex Mex and/or TFM, shippers will be harmed.

Foreclosure can occur through a variety of mechanisms. Physical access can be denied at an interchange to a connecting carrier. The

⁷ See Reishus V.S. at 8-12 and Finance Docket No. 34342, Comments of The Burlington Northern and Santa Fe Railway Company, Verified Statement of Peter J. Rickershauser, August 4, 2003.

foreclosing carrier can provide non-competitive, inefficient service—in terms of scheduling, reliability, speed of delivery, and other aspects important to shippers and connecting carriers. Foreclosure can also occur through economically inefficient and excessive rates or divisions.

Vertical rail mergers often provide pro-competitive benefits to shippers because of enhanced single-line service. To the extent that the new single-line route provides better service to shippers and/or lower cost to the vertically integrated railroad, competition and consumer welfare will be enhanced. But vertical rail mergers also present the opportunity for foreclosure of competition if the merged carrier sets rates for its portion of a joint-line move with an equally or more efficient connecting carrier that effectively shuts out that carrier.

Inefficient foreclosure and loss of competitive discipline can be prevented through an open gateway requirement.⁸ Economically meaningful open gateway conditions require that a disintegrated upstream rail carrier that is as efficient—in terms of relevant costs, reliability, speed, and other characteristics important to specific shippers—as the upstream portion of the vertically integrated carrier be in a position to compete effectively for traffic against the vertically integrated railroad.⁹ Shippers must have a reasonable opportunity to purchase economically efficient transportation service from origin to destination provided by the disintegrated upstream carrier in conjunction with the downstream portion of the vertically-integrated carrier in competition with single-line service provided by the vertically-integrated carrier. For this to occur, the disintegrated upstream carrier must have the possibility of earning revenue on the equally or more efficient upstream

⁸ 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.” Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures, June 11, 2001, at 33.

⁹ The same principle applies when competition occurs downstream with a competitor that vertically integrates upstream.

movement sufficient to cover the relevant costs of providing such service in order for its competitive discipline to be effective.

The Applicants pledge to “keep the Laredo gateway open on commercially reasonable terms.”¹⁰ Moreover, KCS’ Chief Operating Officer testified, “I fully expect as you [the STB] go through your deliberations that you will impose a requirement that the gateways be kept open on commercially reasonable terms, and that's acceptable to us. We intend to do it anyhow. Those kinds of conditions are conditions that simply will foster the development of that marketplace.”¹¹ While open Laredo and Brownsville gateways are required to preserve and potentially enhance competition because of the proposed transaction, the effectiveness of open gateway conditions depends on the details and enforceability of such commitments and conditions.

III. OPEN GATEWAY COMMITMENTS AND CONDITIONS

The Applicants have stated in general terms their intention to keep the Laredo and Brownsville gateways open. Sound rail merger policy requires that the gateways affected by the proposed transactions remain open. Moreover, sound policy calls for commitments and mechanisms to keep these gateways open that are clear, economically efficient and effective, and that are enforceable in an efficient and cost-effective manner. The NIT League Agreement and certain assertions by the Applicants, if imposed as a condition of the merger approval and subject to post-merger oversight by the STB, provide a start toward these public policy goals. Additional conditions are required, however, for regulation to preserve open gateways.

The NIT League Agreement provides, in part, that “KCS and/or Tex Mex will establish and maintain commercially reasonable contract or

¹⁰ Supplemental Application at 24. KCS has also committed to keeping the Brownsville gateway open. Michael R. Haverty, Transcript of Public Hearing on Proposed “KCS-Tex Mex” Railroad Merger, July 31, 2003 at 23.

¹¹ Gerald K. Davies, Transcript of Public Hearing on Proposed “KCS-Tex Mex” Railroad Merger, July 31, 2003 at 173.

common carrier rates and charges over any existing interchange with that [connecting] railroad.”¹² The Agreement calls for arbitration, but arbitration procedures “shall only apply to disputes regarding rates and charges applicable in whole or in part within the U.S.”¹³

The meaning and economic implications of the NIT League Agreement are not always clear, but some of the limitations or omissions of the Agreement for effectively preserving efficient open gateways include:

- The proposed NAFTA Rail is not required to establish commercially reasonable rates on traffic interchanged between UP and TFM at Laredo, or, presumably, between UP or BNSF and TFM at Brownsville.¹⁴
- While not clear, NAFTA Rail appears to only commit TFM to charging commercially reasonable rates and charges for “its portion of *through* movements between Mexico and the U.S.” (emphasis added) on moves that Tex Mex interchanges with BNSF (or UP).¹⁵ The Agreement does not clearly require that TFM provide a commercially reasonable rate for the majority of Mexico bound traffic that terminates at the U.S.-Mexico border for further shipment into Mexico by the Mexican receiver.
- “Commercially reasonable” has no further definition and is left up to the parties and arbitrator to determine its meaning and economic

¹² NIT League Agreement at ¶2(a). Paragraph 2(a) continues: “Such rates and charges shall be either through rates and charges or, if requested by a shipper or connecting railroad on behalf of a shipper to support the commercial terms of trade where the title to the goods being shipped transfers at the border, rates and charges for service within the U.S. to or from the international border between Mexico and the U.S. or within Mexico to or from the international border between Mexico and the U.S.”

¹³ NIT League Agreement at ¶2(c).

¹⁴ Letter to David L. Meyer from Nicholas J. DiMichael, Frederic L. Wood, and William A. Mullins, NITL-4 & KCS-17, August 18, 2003 (“NIT League-KCS Letter”).

¹⁵ NIT League-KCS Letter at 1.

content. There is no assurance that “commercially reasonable” as determined by the Agreement would permit economically efficient outcomes or effective competitive discipline by BNSF.¹⁶ What little explanation has been provided is not encouraging: “The meaning of the term ‘commercially reasonable’ ... would be determined by the parties to the process of establishing and maintaining the rates and charges to the shipper as a whole (not to individual railroad divisions or rate factors).”¹⁷ This murky explanation appears to leave open the possibility that “commercially reasonable” need not apply to the division demanded by NAFTA Rail entities, but only to the through rate that shippers pay for the joint-line movement. But in the absence of a meaningful, enforceable requirement on the total NAFTA Rail *division*, the Agreement provides no mechanism by which efficient competitive outcomes are protected.

- TFM rates are not subject to arbitration, and there is no enforcement mechanism to ensure that the rates charged by TFM are “commercially reasonable,” apart from existing Mexican regulation and enforcement mechanisms.¹⁸
- The Agreement is silent with respect to service quality or other terms and conditions (apart from “rates and charges”) provided by NAFTA Rail as part of a joint-line movement.

The NIT League Agreement, even if imposed as a condition for approval of the transaction, goes only part way toward assuring an effective open gateway. The Agreement, as explained by NIT League and KCS, is far from clear in requiring that NAFTA Rail offer *divisions* to BNSF for traffic moving between the U.S. and Mexico over BNSF-Tex Mex-TFM routings that

¹⁶ NIT League-KCS Letter at 2.

¹⁷ NIT League-KCS Letter at 2.

¹⁸ NIT League-KCS Letter at 2.

would permit an efficient competitive alternative.¹⁹ For efficient competition to occur, the total division charged by the NAFTA Rail portion of a U.S.-Mexico move, whether in the U.S. (by Tex Mex and/or KCSR) or Mexico (by TFM), must be such that BNSF can efficiently compete for the upstream U.S. portion of the move where it offers equally or more efficient service. For BNSF to compete efficiently for the shipper's business, it must be able to offer a total rate and service package to the shipper for the total movement that compensates BNSF for the relevant costs on its portion of the move and provides NAFTA Rail with its required division. Unreasonable or inefficient division requirements by NAFTA Rail could prevent BNSF from competing for traffic even when it was the most efficient upstream carrier.

Moreover, the Agreement imposes no restrictions on the quality of service to be offered on interline movements. Since a gateway can be closed physically, through rates, or through inferior service, the Agreement does not assure an effective open gateway in the absence of a competitive service commitment.²⁰

Finally, if KCS succeeds in gaining control of TFM, the NIT League Agreement provides no restriction on TFM's rates or service provided on interline traffic with UP at Laredo or with UP and BNSF at Brownsville. The Agreement hardly seems to enforce KCS's commitment to maintain open gateways when it imposes no restriction on TFM's rates or service on traffic

¹⁹ It makes no sense in the context of open gateways to speak only of maintaining "commercially reasonable rates" to the shipper as a whole, since a connecting carrier's ability to set a revenue requirement for its portion of a joint-line movement that result in rates that are competitive as a whole depends on the divisions of those rates required by the carrier controlling the gateway. If the carrier controlling the gateway insists on a division that disables the connecting carrier from participating in the movement, even when the joint-line service is equally or more efficient than the single-line service, then competition is foreclosed.

²⁰ KCS frequently complains about the quality of service provided to Tex Mex under the terms of the trackage agreement with UP as preventing efficient operation by a KCSR-Tex Mex routing. See, for example, Michael R. Haverty, Transcript of Public Hearing on Proposed "KCS-Tex Mex" Railroad Merger, July 31, 2003 at 34.

interchanged with UP at Laredo, as UP is the U.S. carrier responsible for the lion's share of rail traffic passing through Laredo.

The Applicants' general promises and the NIT League Agreement are inadequate for maintaining open gateways at risk from the proposed transactions, but do represent a starting point. In addition to conditioning approval of the transaction on the Applicants' commitments and the Agreement, the Board could better ensure an open gateway by extending the underlying principle of the Agreement to encompass rates, charges, and service so that NAFTA Rail's division of any movement interchanged at Robstown, Laredo, or Brownsville reflect commercially reasonable terms and conditions.

Experience demonstrates that open gateway provisions can be effective and efficient.²¹ While privately negotiated agreements are often the most effective mechanism for achieving economically efficient outcomes, the Board's role in establishing the guidelines under which such agreements are reached can be crucial. By setting clear and economically rational guidelines and conditions, the Board can preserve existing competitive options with little or no loss of cost reductions and service improvements achievable through vertical rail consolidation.

IV. TRANSITION RULES

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."²² However, "... KCS is not willing to simply renew such an agreement under the old terms without undertaking a good faith

²¹ See discussion of the Canadian National/Wisconsin Central transaction below.

²² Supplemental Application at 26.

negotiation.”²³ KCS has indicated an unwillingness to limit rate and division increases for any period beyond the expiration of existing agreements.

By contrast, as part of their 2001 minor transaction, Canadian National (“CN”) and Wisconsin Central (“WC”) agreed to maintain open gateways and, as one mechanism for achieving this, agreed to limit rate increases for five years on through rates over the gateway to a measure of railroad costs.²⁴ This agreement appears to have generated little controversy, and has presented no discernable impediment to the efficient implementation of the merger. There has been no mention of these requirements in any of the post-merger oversight proceedings nor, to my knowledge, has any dispute arisen over the interpretation or implementation of the relevant agreements or conditions.

KCS argues that, rather than accepting any limitation on rate increases as part of a transition to open gateways, the existing agreements should be renegotiated in good faith. The convoluted history of the existing BNSF-Tex Mex marketing agreement, however, raises doubts about the success of such prospective negotiations with KCS. The existing division and marketing agreement was negotiated in early 1998 between BNSF and Tex Mex. This pro-competitive 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. After Tex Mex and BNSF had reached agreement, KCS intervened to prevent Tex Mex executing the agreement with BNSF.²⁵ KCS based its right to

²³ Supplemental Application at 26.

²⁴ 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 12-13.

²⁵ 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.

intervene between Tex Mex, which KCS putatively did not control, and BNSF on an agreement that it had not disclosed to the Board when the Board evaluated competitive replacements to SP for access to Laredo. Several months of wrangling, several filings to the Board, and the Board's indication that it was willing to impose a rate, if necessary, was required before BNSF and Tex Mex were able to execute the agreements. This experience does not provide confidence in the ability of BNSF to reach a pro-competitive agreement for rates and marketing of joint-line movements with Tex Mex for traffic over the Laredo gateway through good faith negotiations with KCS.²⁶

BNSF has requested that, as part of the open gateway condition, a transition rule be imposed to limit rate increases for a fixed period following the transaction. Transitional rate caps following mergers or a significant structural change in regulated network industries are a common tool of regulatory policy.²⁷ While rail regulation reflects the unique characteristics of the rail industry, such a transition mechanism for joint-line movements over major gateways is unlikely to create inefficiencies in merger implementation or to have any significant anti-competitive impact. The CN/WC experience suggests that such limitations will have little or no negative impacts.

The Applicants have indicated that they do not expect to make major changes in the operations of the segments of the proposed NAFTA Rail

²⁶ Indeed, as discussed in BNSF's Reply, the 1998 BNSF-Tex Mex agreement is set to expire in three months, and BNSF has yet to obtain from either Tex Mex or KCS and indication of their proposed terms for renewal.

²⁷ See, for example, Federal Energy Regulatory Commission, Docket No. RM96-6-000, Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act, Policy Statement, Order No. 592, Policy Statement Establishing Factors The Commission Will Consider in Evaluating Whether a Proposed Merger is Consistent with the Public Interest, December 18, 1996 at 42; Federal Energy Regulatory Commission, Docket Nos. EC99-1-000 & ER99-34-000, Sierra Pacific Power Company and Nevada Power Company, Order Approving Merger and Conditionally Accepting for Filing Proposed Joint Open Access Transmission Tariff, April 15, 1999, at 16-17; and Federal Energy Regulatory Commission, Docket No EC00-49-000, Consolidated Edison, Inc. and Northeast Utilities, Order Approving Merger, June 1, 2000 at 11-13.

system. Indeed, the lack of projected changes has made certain interveners question how KCS can financially justify the transactions.²⁸ In the absence of such major changes, the imposition of a limited rate cap for a fixed period after the transaction is approved is unlikely to generate any significant anticompetitive effects, nor is it likely to impose significant regulatory burdens. To the extent it prevents anti-competitive rate increases because of the change in control, shippers benefit and public welfare is improved.

If NAFTA Rail does make significant changes, a transition period will allow shippers time either to adjust their logistics requirements or to develop competitive alternatives. A transition period could provide the opportunity to make investments and develop alternatives that would avoid potential significant disruptions. Given the controversy between Grupo TMM and KCS concerning the NAFTA Rail transactions, post-transaction implementation of these transactions, if they occur, might be particularly rocky and poorly coordinated. A transition that preserved terms in existing agreements during the post-transaction implementation period would reduce uncertainty and ameliorate merger-related service disruptions and economic dislocations.

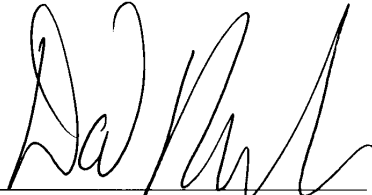
A rate cap transition rule does not prevent private negotiation by NAFTA Rail with its connecting railroads or shippers. These parties would be free to negotiate lower, incentive rates to increase volumes of shipments. In addition, to the extent that NAFTA Rail can provide valuable enhanced service for certain movements, shippers and connecting railroads would presumably be willing to accept higher charges for those services when the benefits outweigh the costs. As such, while the rate cap limits the absolute discretion of NAFTA Rail for a limited period, it does not “freeze” rates permanently nor does it preclude pro-competitive, private negotiations to respond to specific shippers needs or demand incentives.

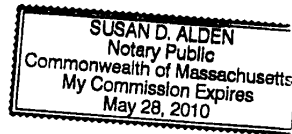
²⁸ See, for example, Finance Docket No. 34342, Comments of Canadian National Railway Company, August 4, 2003.

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 Reply Verified Statement.

Executed on August 29, 2003.



David Reishus

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.

James D. Prael