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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EX PARTE NO. 658

**THE 25TH ANNIVERSARY OF THE STAGGERS RAIL ACT OF 1980:
A REVIEW AND LOOK AHEAD**

OCTOBER 19 HEARING

**WRITTEN STATEMENT OF
MR. RONALD G. RUSS ON BEHALF OF
THE KANSAS CITY SOUTHERN RAILWAY COMPANY**

Dated: October 12, 2005

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INTRODUCTION

Chairman Nober, Vice Chairman Buttrey, Commissioner Mulvey, and members of the STB staff, I am Ron Russ, Executive Vice President and Chief Financial Officer for Kansas City Southern ("KCS") and its wholly owned Class I subsidiary, The Kansas City Southern Railway Company ("KCSR"). I joined KCS in 2002. Before joining KCS, I had served in several capacities at Wisconsin Central, including two years as Executive Vice President and Chief Financial Officer, and five years as Executive Manager and Chief Financial Officer for Tranz Rail Holdings Limited, its affiliate in New Zealand. I have spent twenty-eight years in the rail industry, including service with Soo Line Railroad and the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. I received a B.S. in Commerce from DePaul University in Chicago, IL.

I would like to thank the Board for allowing KCS the opportunity to provide its input on the Staggers Rail Act and its implementation by the Surface Transportation Board ("STB"). As an overall comment, my observation is that without the Staggers Rail Act, and the way it has been implemented by this Board and its predecessor, the Interstate

Commerce Commission (ICC), the rail industry would not have survived as we know it. In KCS's opinion, the Act should not be changed in any significant way, nor should the Board change its precedents implementing that Act.

In coming to this conclusion, it is first necessary to discuss a little history of KCS, where it's been, and the role Staggers played. Second, I want to discuss the role of KCS today, both domestically and internationally. Finally, I would like to discuss the importance of attracting sufficient capital to the rail industry, the role that capital plays with respect to the rail industries' infrastructure needs, and why Staggers is critical to that role.

I. HISTORY OF KCS AND THE ROLE OF STAGGERS

In 1980, when Congress passed the Staggers Rail Act, all railroads were struggling to survive. Service was poor, infrastructure was crumbling, we were all losing customers, and there was insufficient revenue to invest in our very capital-intensive industry. With passage of Staggers and de-regulation of the rail industry, KCSR, like the industry as a whole, was able to adjust its revenues to market conditions, increase its investment in its infrastructure, and improve service. Efficiencies were realized, and once again we were positioned to compete for business with motor carriers.

As we approached the 1990s, massive consolidation in the industry left KCSR as the smallest of the remaining Class I railroads. KCSR was either going to be acquired, continue to shrink, or it was going to grow. Under the leadership of our Chairman, Michael Haverty, KCSR decided to grow. The MidSouth Railroad had been acquired by KCSR in 1993, setting the stage for what would be KCS' eventual growth strategy. In 1995, KCS invested in minority ownership of The Texas Mexican Railway Company

("Tex-Mex") in south Texas. Also in 1996, the STB granted the Tex-Mex trackage rights over the Union Pacific ("UP"), as part of the Union Pacific/Southern Pacific merger proceeding, which made our next move possible. In December 1996, KCS and its partner, Grupo TMM, a Mexican transportation company, won the concession for the privatization of Mexico's northeast railroad, which became TFM after privatization. In 1997, KCS acquired Gateway Western and Gateway Eastern Railways. Since then, KCSR has entered into various marketing agreements, including a marketing alliance with Canadian National ("CN"), a marketing alliance with Burlington Northern-Santa Fe ("BNSF"), a haulage agreement with Norfolk Southern ("NS") for the movement of intermodal traffic over KCSR's east-west line between Meridian, MS and Dallas, TX known as the "Meridian Speedway", and finally, a haulage agreement with Iowa Chicago & Eastern ("IC&E") for the movement of grain to domestic receivers on KCSR and for export to Mexico. Recently, KCS completed its acquisition of 100% control of both Tex-Mex and TFM, firmly establishing that vital, second rail competitor to the Laredo gateway as envisioned by the STB in 1996.

None of these franchise-strengthening actions would have been possible in a pre-Staggers regulatory structure, nor would KCS have been able to undertake these actions if the ICC/STB had implemented Staggers in a different way or had taken a more activist role in the marketplace. It was only by allowing the marketplace to govern, subject to this agencies' role in preserving and maintaining competition that KCSR was to able survive and even prosper.

II. THE ROLE OF KCS TODAY

Even though KCSR today still remains the smallest of the Class I railroads, it nonetheless plays a significant role in providing shippers with an independent, competitive presence in the marketplace. In many situations, we are a regional bridge carrier for shippers who look to us to provide a competitive alternative in routing their shipments. We provide that competitive option for shippers, but we also work with our competitors because we rely on them for the interchange. Probably more than any other Class I carrier, our survival depends both on our ability to compete against our competitors and our ability to efficiently interchange with them.

The Staggers Rail Act, along with aggressive and focused management, has allowed KCS to become a critical alternative for the transportation of grain, chemicals, and paper products, both domestically and internationally. KCSR's Meridian Speedway, with infrastructure and capacity improvements underway, holds great promise for the movement of intermodal freight in the transcontinental market and is the most direct connection from the southwest and west coast to the Atlanta and Southeastern markets. With the ownership of KCSR, Tex-Mex, and TFM under the control of a single holding company, KCS now presents the best competitive alternative for the movement of NAFTA traffic to and from Mexico, and it presents the greatest opportunity for growth in the future.

The combination of KCSR, Tex-Mex, and TFM has already strengthened the system financially, with KCS' revenues doubling as result of the acquisition of TFM, and we foresee even better results in the future. We have begun the process of integrating operations, purchasing, accounting, marketing, communications, and IT functions in the

United States and Mexico. Train operations are now better coordinated. Also, new management has been installed at TFM. These actions, and more, will help KCS to achieve the needed efficiencies to provide rail shippers with a better competitor between the U.S. and Mexico.

Of course, KCS' ultimate goal is to increase the amount of traffic flowing over the KCS NAFTA Rail network. Most of the growth will come from the increased projected trade between Canada, the United States, and Mexico, from our ability to move traffic from the other modes, including off our highways onto the rail system, and some will come through the development of the Port of Lazaro Cardenas to move traffic between Asia, Mexico, the U.S. and Canada. Indeed, most of the overall NAFTA trade is transported by other modes. Rail represents only a 17% share of that overall market in Mexico. We intend to change that. We will do so by providing the most cost-effective, safest, and most environmentally responsible way to move the ever growing volumes of freight that will be required in the NAFTA trade in the future.

However, we cannot do this if Staggers changes and the industry is re-regulated. What this Board, and the Congress, must resist is the urge to change the Staggers Act in a way that would hamper ours and other railroad's efforts to better compete with other modes in the NAFTA trade corridor. Calls by some for the regulation of rate making freedoms, such as the requirement to establish bottleneck rates, both domestically and internationally to/from the borders, or for this agency to be involved in the setting of divisions to/from gateways, should be rejected. Such regulation would eliminate the railroads' ability to achieve adequate revenues and to price according to the market.

III. THE NEED FOR ADEQUATE REVENUES IN ORDER TO ACHIEVE SUFFICIENT GROWTH AND INCREASED INFRASTRUCTURE

Perhaps the most critical component for KCS's ability to continue to provide an effective competitive rail alternative and to increase the rail industry's share of the overall NAFTA trade market is the need for railroads to achieve adequate returns. Despite the successes of the Staggers Act, or perhaps I should say because of the successes of the Staggers Act, the nation's railroads -- both large and small -- are at crossroads. KCS, like other railroads, is finding it more and more difficult to replace, improve, and expand its infrastructure in order to keep pace with today's increased traffic growth.

Railroads are very capital intensive. As you know, unlike the trucking industry, which we view as our prime competitor, railroads finance virtually all of their own right-of-way maintenance and improvements. KCS, like other rail carriers, must increase its revenues and raise sufficient capital to not only maintain its existing infrastructure, but at the same time, plan for, and build, the necessary expansion infrastructure to remain competitive for both our existing traffic and for future traffic. This is a challenging task.

This year domestically in the U.S., KCSR will spend approximately \$65 million for maintenance capex and \$56 million in rolling stock, IT and other assets just to maintain our existing infrastructure. That's about 17% of our operating revenues for the year. On top of that, KCSR will spend this year about approximately \$42 million more to expand the capacity of our rail infrastructure and \$60 million for new, high horsepower locomotives. KCS could easily spend 100% of its existing capital budget to accommodate all of the capacity expansion projects necessary for KCS to truly build for the projected future growth on our system. Obviously this is unrealistic. We need to

grow revenues so that we can raise the new capital needed to expand our system to meet demand for rail transportation in the future.

The fact is that as the economy has grown and the railroad's share of that growth has increased, existing capacity is simply not enough to accommodate growth. In fact, U.S. Department of Transportation projections indicate that rail tonnage will increase well over 55% by 2020 from 2000 levels. We simply don't have the existing infrastructure capability to accommodate this growth and substantial capital investment by the rail industry will be required for many years to come.

To illustrate the challenge we face at KCS, for example, within the confines of our existing revenue base, KCSR and Tex-Mex are undertaking a significant number of capital projects to expand capacity for the future. The combined U.S. network is increasing yard capacity in three major yards. KCSR is adding centralized traffic control at several locations on the Meridian Speedway and extending sidings or double tracking at another six locations. Recently Tex-Mex obtained a \$50 million RRIF loan from FRA to rehabilitate the Tex-Mex line in south Texas. These projects are necessary for KCS to remain competitive for the existing traffic base.

KCS is also planning for the future. KCS is working with third parties to arrange the necessary financing to rebuild and rehabilitate the Victoria to Rosenberg corridor so as to free up capacity on the UP lines used by Tex-Mex via its trackage rights. Unfortunately, UP's lines in and around Houston remain heavily congested, significantly slowing Tex-Mex's transit times. By avoiding use of the 160 route miles of UP trackage rights, the rebuilding of the Victoria to Rosenberg line alone will help relieve some of the congestion in the future. KCS is also funding existing grade crossing relocations and

closures with state, federal, and private dollars as necessary to improve safety and eliminate congestion. All of these projects require significant funding strategies, funding that is many times difficult to come by in capital markets.

The bottom line is that for railroads like KCS and others to continue to prosper and to plan for future growth, access to capital for capacity improvements continues to be a significant priority. The need to increase rail infrastructure capacity, and thus the need to obtain access to capital for this investment, is obvious. KCS can raise revenues and improve its capital picture by cutting costs, using government funding mechanisms in public/private partnerships where there are significant benefits to the public interest, and by looking at ways improve productivity through technology investment. Federal capital investment tax credits for Class I railroads, like those granted by Congress to the shortline railroads, would also help. But all of those options have limits.

The best way to ensure that the necessary capital continues to remain available is for the STB to ensure that railroads like KCS can earn adequate returns in the future. To do so, this agency needs to avoid the calls by some to regulate railroad pricing authority or to place artificial caps on railroad pricing authority. It is clear that even under existing pricing freedoms, railroads as an industry are still not earning sufficient returns to accommodate future growth. This is true whether or not a railroad is deemed "revenue adequate" under STB regulations. What is needed is more revenue and new capital, even if one is already earning its cost of capital. Earning your cost of capital does not equate to access to future capital for projected growth. It would be a mistake for this agency to adopt policies that would undermine the goals of providing sufficient access to capital markets simply because one has been deemed revenue adequate.

CONCLUSION

In conclusion, the Staggers Rail Act of 1980 has been one of the most successful pieces of transportation legislation ever passed. It has achieved its goal of improving the financial health of the rail industry while at the same time making rail transportation a competitive service option for shippers. It has allowed railroads to attract capital, improve infrastructure, and shed unproductive and inefficient lines.

With respect to KCS, it has allowed KCS to grow into a strong and viable independent competitor to the larger rail systems. It has also allowed KCS to become an international railroad transportation holding company and a viable force in the NAFTA trade corridor.

Yet, as KCS and the economy have grown, and rail has become more competitive with other modes, the industry, including KCS, now faces a capacity crunch. Despite the improvements in the ability to raise capital, most of this capital now goes to maintaining and improving existing capacity as necessary to accommodate the existing traffic base and existing customers, rather than going to building new capacity to accommodate future growth and new customers. For KCS and other railroads to truly reach their potential and to accommodate their future capacity needs, significant new capital must be raised.

New capital can be raised in a variety of ways, but efforts by this agency or Congress to change Staggers or to otherwise reduce railroads' pricing freedoms would be contrary to this goal. With the new century underway, the exacting demands of a global economy, and the skepticism of some in Congress, I urge you to "do no harm" and maintain the existing regulatory structure and framework of Staggers.