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KARL MORELL



June 14, 2006

BY HAND DELIVERY

The Honorable Vernon Williams
Secretary
Surface Transportation Board
1925 K Street, N.W., Suite 700
Washington, DC 20423-0001

ENTERED
Office of Proceedings

JUN 14 2006

Part of
Public Record

Re: STB Ex Parte No. 659, Public Participation in Class Exemption Proceedings

Dear Secretary Williams:

Attached for filing are the original and ten copies of the Reply Comments of Watco Companies, Inc.

Please time and date stamp the extra copy of the Reply Comments and return it with our messenger.

If you have any questions, please contact me.

Sincerely yours,

Karl Morell

Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 659



PUBLIC PARTICIPATION IN CLASS EXEMPTION PROCEEDINGS

REPLY COMMENTS OF WATCO COMPANIES, INC.

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Dated: June 14, 2006

BEFORE THE
SURFACE TRANSPORTATION BOARD



STB Ex Parte No. 659

PUBLIC PARTICIPATION IN CLASS EXEMPTION PROCEEDINGS

REPLY COMMENTS OF WATCO COMPANIES, INC.

Watco Companies, Inc., and its 16 railroad subsidiaries hereby submit these reply comments in response to the Surface Transportation Board's ("Board") decision served March 10, 2006, in this proceeding ("Decision").

BOARD PROPOSAL

In the Decision, the Board seeks comments on whether to increase the timeframes before certain exempt transactions become effective. More specifically, the Board proposes to increase to 30 days the effective date of all 10 class exemptions that currently become effective 7 days after filing.¹ With respect to the class exemptions at 49 C.F.R. §§ 1150.35 and 1150.45 that involve the creation of a Class I or Class II carrier, the effective date of the exemptions would be

¹ The two class exemptions under 49 U.S.C. §§ 10901 and 10902 are: (1) Exempt Transactions Under 49 U.S.C. 10901 (49 C.F.R. § 1150 Subpart D) ("Section 10901 Exemption"); and (2) Exempt Transactions Under 49 U.S.C. 10902 For Class III Rail Carriers (49 C.F.R. § 1150 Subpart E) ("Section 10902 Exemption"). The eight class exemptions under 49 U.S.C. § 11323 are set forth at 49 C.F.R. § 1180.2(d)(1) through (8) ("Section 11323 Exemptions"). The 10 class exemptions the Board seeks to modify are referred to collectively as the "Ten Exempt Transaction Types".

increased to 45 days from the current 21 days after filing and the current 14-day advance notice of intent to file would remain unchanged.

INTEREST OF WATCO

Watco Companies, Inc., a non-carrier, is a Kansas corporation which currently controls the following sixteen (16) Class III railroads operating in fourteen (14) States: South Kansas and Oklahoma Railroad Company, Palouse River & Coulee City Railroad, Inc., Timber Rock Railroad, Inc., Stillwater Central Railroad, Inc., Eastern Idaho Railroad, Inc., Kansas & Oklahoma Railroad, Inc., Pennsylvania Southwestern Railroad, Inc., Great Northwest Railroad, Inc., Kaw River Railroad, Inc., Mission Mountain Railroad, Inc., Mississippi Southern Railroad, Inc. ("MSRR"), Yellowstone Valley Railroad, Inc., Louisiana Southern Railroad, Inc., Arkansas Southern Railroad, Inc., Alabama Southern Railroad, Inc., and Vicksburg Southern Railroad, Inc.

Watco Companies, Inc., and its subsidiary railroads ("Watco") have utilized most of the Ten Exempt Transaction Types and anticipate utilizing these class exemptions in the future. The Ten Exempt Transaction Types are particularly beneficial to Watco and the rest of the short-line and regional railroad industry because they provide an expeditious and cost-effective means of serving new markets, changing operations or streamlining corporate organizations.

INITIAL COMMENTS

Comments in response to the Board's proposal were filed by the Association of American Railroads ("AAR"), the American Short Line and Regional Railroad Association ("ASLRRA"), Genesee & Wyoming Inc. ("GWI"), the State of New Jersey ("New Jersey"), the Rail Labor Division of the Transportation Trades Department, AFL-CIO, the Rail Conference of the International Brotherhood of Teamsters, and the United Transportation Union-General Committee of Adjustment.

WATCO'S REPLY COMMENTS

Initially, Watco endorses the comments filed by ASLRRA and GWI. As pointed out by these two parties, the proposed changes will be harmful to the short line and regional railroad industry with little, if any, countervailing benefits to the general public. If adopted, the proposed changes will increase the cost and delay the consummation of all transactions that fall within the ambit of the Ten Exempt Transaction Types. These increased costs will either be passed along to the shipping public where possible or absorbed by the carrier. Thus, the proposed changes will inevitably lead to increased transportation costs and financially weakened railroads. Moreover, where time is of the essence or where the economics of a particular transaction are slim, the increased costs and regulatory delay can be the death knell of the transaction.

An example of a transaction that may not have been undertaken if the proposed changes had been in effect is MSRR's lease of a 26.5-mile line from The Kansas City Southern Railway Company ("KCS") in Mississippi. KCS had taken the rail line between Newton and Bay Springs out of service because the traffic was insufficient to justify the needed repairs for continued operations. Watco was contacted by Senator Lott on behalf of the shippers on the line to see if it were economically feasible for Watco to repair and operate the line. Within **10 days** of the call from Senator Lott, Watco repaired the line, entered into a lease agreement with KCS, filed and obtained the requisite lease and operating authority from the Board and commenced operations over the line. Under the proposed rule changes, the shippers on that line, at a minimum, would have been without rail service for over 30 days and suffered increased transportation costs. More likely, these shippers would have lost rail service altogether. The operations on the 26.5-mile line are economically marginal. Therefore, it is unlikely that Watco would have risked the repair and transaction costs if Watco had to wait more than 30 days to commence operations since the

shippers would have been forced to make alternative transportation arrangements which arrangements may or may not have been irreversible.

Watco also agrees with AAR's suggestion that the transactions falling within the Section 11323 Exemptions are completely routine and non-controversial and do not require additional public notice. In addition, Watco shares AAR's concern regarding the abuse of the class exemption process by certain parties outside the railroad industry. Watco, however, takes strong exception to AAR's suggested solutions and recommended changes to the Section 10901 and 10902 Exemptions. AAR's recommendations are undoubtedly well intentioned but unfortunately they are overbroad and ill-advised. AAR would have the Board penalize the entire short line industry in an attempt to halt the few, isolated instances where the Board's procedures are being abused. AAR exaggerates the extent of the problem and suggests a cure that will not only harm the overwhelming number of legitimate operators but provides little, if any, deterrence to the abusers.

ARR's proposal to re-regulate the short line industry is based on several faulty notions. First, AAR seems to suggest that the original purpose of the class exemption procedures have been met and that, therefore, these expedited and cost-effective procedures are no longer necessary. *See* AAR Comments at 5-6. Many of the Class I carriers, however, continue to spin off marginal lines. *See e.g.*, STB Docket No. 34765, *Vicksburg Southern Railroad, Inc. – Lease and Operation Exemption – The Kansas City Southern Railway Company* (not printed), served January 13, 2006; STB Docket No. 34772, *R.J. Corman Company/Tennessee Terminal, LLC – Lease and Operation Exemption – BNSF Railway Company* (not printed), served February 3, 2006 (“*Corman*”); STB Finance Docket No. 34801, *Western New York & Pennsylvania Railroad, LLC – Lease and Operation Exemption – Norfolk Southern Railway Company* (not

printed), served January 18, 2006; and STB Finance Docket No. 34729, *Saginaw Bay Southern Railway Company – Acquisition and Operation Exemption – Rail Line of CSX Transportation, Inc.* (not printed) served September 27, 2005. In addition, the short line and regional railroad industry itself is in an ongoing process of restructuring with Class II and III carriers buying each other's rail lines for various operational or economic reasons. *See e.g.*, STB Finance Docket No. 34856, *Four Rivers Transportation, Inc. – Control Exemption – Appalachian & Ohio Railroad, Inc.* (not printed), served May 23, 2006; STB Finance Docket No. 34846, *Pennsylvania Northeast Regional Railroad Authority – Acquisition Exemption – Lackawanna County Railroad Authority* (not printed), served June 5, 2006. Moreover, formerly shipper-owned rail lines are being sold to short line operators. *See e.g.*, STB Docket No. 34328, *Pennsylvania Southwestern Railroad, Inc. – Lease and Operation Exemption – J&L Specialty Steel, LLC* (not printed), served April 24, 2003 (“*Pennsylvania*”).

According to Board's Annual Reports, the number of Notices filed under the Section 10901 and 10902 Exemptions have been fairly steady over the past decade:²

	<u>Section 10901 Notices</u>	<u>Section 10902 Notices</u>	<u>Total</u>
FY 1996	63	20	83
FY 1997	34	39	73
FY 1998	53	25	78
FY 1999	21	31	52
FY 2000	36	28	64
FY 2001	41	31	72
FY 2002	52	22	74
FY 2003	34	34	68
FY 2004	37	27	64

² The data for Fiscal Years 1996 through 2001 are from the Board's FY 1998/1999/2000/2001 Report and the data for Fiscal Years 2002 through 2004 are from the Board's FY 2002-2004 Report.

As these statistics demonstrate, the two class exemptions are continuing to be used by the short line industry and they are as important to the industry today as they were when first adopted. Legitimate new operators and existing Class III carriers have a continuing need to respond quickly to existing transportation needs or transportation opportunities. Accordingly, the Board should not discount the importance of the current 7-day Notices to the continued success of the short line industry.

Second, AAR appears to exaggerate both the scope and nature of the problem. AAR describes the scope of the abusive filing as “a growing trend”. (AAR Comments at 3 and 6.) AAR claims that “[t]oday, more and more entities” are filing “controversial proposals”. (AAR Comments at 6.) Few examples of abusive filings, however, are cited by AAR and the other parties to this proceeding. In Watco’s view, the abusive filings are troubling and need to be stopped but they have been few and isolated especially when considered in the context of the numerous legitimate filings that benefit both the shipping public and short line industry. Moreover, the abusive filings may have already ebbed and are on the decline as the Board and rail industry becomes more vigilant in addressing the problem.³

AAR also fails to demonstrate any irreparable harm caused by the abusive filings that have not or cannot be adequately addressed and resolved either under the Board’s existing procedures or new procedures less draconian than those suggested by the AAR. For example, AAR cites the investigation of Comrail International Railroad (“Comrail”) in support of its

³ One of the abusive filings cited by AAR involved Atlantic and Pacific Railroad and Transportation Company (“APR”). In 2004, one of Watco’s subsidiaries agreed to lease 4 miles of rail lines to APR on the representation that APR needed the track to store rail cars. Once the misrepresentation came to Watco’s attention, the lease was terminated and APR was asked to obtain discontinuance authority from the Board. Watco has learned its lesson and will much more carefully scrutinize any future requests to purchase or lease any of its rail lines.

suggested changes to the Section 10901 and 10902 Exemptions. According to the Board's records, however, the Director of the Board's Office of Compliance and Enforcement ("Director") was able to resolve this matter within 9 days of taking action. On February 11, 2003, the Director questioned Comrail's operations and by February 20, 2003, Comrail withdrew its notice which had become effective on December 11, 2002. *See* STB Finance Docket No. 34291, *Comrail International Railroad, Inc. – Operation Exemption – Chicago Heights Railcar, Inc.* (not printed) served February 26, 2003 ("*Comrail*"). Similarly, in another case relied on by the AAR, the Board was able to act quickly and stay the Notice filed under the Section 10901 Exemption before it became effective. About three months after it was filed the Board rejected the Notice as inappropriate for the Section 10901 Exemption. *See* STB Finance Docket No. 34734, *Northeast Interchange Railway, LLC – Lease and Operation Exemption – Line in Croton-On-Hudson, NY* (not printed), served August 5, 2005 and November 18, 2005 ("*Northeast*"). If anything, the *Comrail* and *Northeast* proceedings demonstrates that, if the Board is vigilant and aggressively addresses the abusive filings, the Board's existing procedures are adequate to rectify many, if not most, of the problem filings.

Third, AAR's position with respect to the Section 10902 Exemption appears inconsistent with its position regard the Section 11323 Exemptions. All of the abusive filings cited by the parties to this proceeding were under the Section 10901 Exemption. The Section 10902 Exemption only encompasses transactions initiated by existing Class III railroads. The Board and the railroad industry should have some record as to whether the operations of an existing Class III railroad are bona fide and, if not, the Board can readily stay or summarily dismiss any subsequent Notice under the Section 10902 Exemption. Moreover, the Board already has jurisdiction over existing Class III carriers and, thus, can take other remedial action if an abusive

filing is made under the Section 10902 Exemption. From a standpoint of halting abusive filings, no discernable distinction can be drawn between the Section 11323 Exemptions and the Section 10902 Exemption. Both involve routine, non-controversial filings by railroads already subject to the Board's jurisdiction.

AAR's position with respect to the Section 10902 Exemption is also at odds with the Congressional intent underpinning Section 10902:

[T]his new provision***establishes a clear statutory division between transactions involving large Class I railroads on one hand and smaller railroads on the other. This should promote clearer and more expeditious handling of the affected transactions and avoid imposing additional and sometimes potentially fatal costs on start-up operations of smaller railroads who often can keep rail lines in service, even if not viable as part of a larger carrier's system.

H.R. Conf. Rep. No. 422, 104th Cong., 1st Sess. 179-80 (1995). The AAR proposal would turn the Congressional intent on its head by having the Board adopt procedures for Class III railroads that are substantially more onerous than those that can be utilized by the Class I railroads.

Fourth, and most importantly, the harm to legitimate members of the short line industry that will be caused by AAR's recommendations vastly outweigh any deterrent effect these recommendations may have on abusive filings. For example, the AAR would bar the use of the Section 10901 and 10902 Exemptions for the acquisition or lease of trackage that is considered excepted track under 49 U.S.C. § 10906 for its current owner but not for the acquiring entity. If adopted, this recommendation would force transactions such as those involved in *Corman*; STB Finance Docket No. 34509, *Kaw River Railroad, Inc. – Acquisition and Operation Exemption – The Kansas City Southern Railway Company* (not printed), served June 24, 2004; *Chicago Rail Line, L.L.C. – Lease & Oper. – Union Pacific RR Co.*, 2 S.T.B. 534 (1997); and *Effingham RR*

Co. – Petition For Declaratory Order, 2 S.T.B. 606 (1997) to be pursued through the much more onerous and time consuming petition or application procedures.⁴

The AAR recommendations would also limit the Section 10901 and 10902 Exemptions to transactions that involve a rail line currently owned or leased by a carrier subject to the Board's jurisdiction. If adopted, this recommendation would remove transactions such as those involved in *Pennsylvania* from the ambit of the Section 10901 and 10902 Exemptions.

In addition, the AAR would preclude the purchase of abandoned rail lines under the Section 10901 and 10902 Exemptions. While the acquisition of abandoned rail lines is no longer as prevalent as it was 20 years ago, it does still occur and should be encouraged where there is a legitimate need for rail service which a legitimate operator is willing to provide. Because these are very marginal operations, they should not be saddled with additional costs and regulatory delays. In any event, AAR fails to explain why abandoned rail lines should be removed from the ambit of the Section 10901 and 10902 Exemptions but preserved under 49 C.F.R. § 1180.2 (d)(1) which permits the acquisition of certain rail lines that have been approved for abandonment.

While New Jersey supports the Board's proposal, its filing demonstrates the ineffectiveness of the proposed 30-day notice period. According to New Jersey, few state and local agencies have the resources to monitor the *Federal Register* on a daily basis. If the state and local agencies that are concerned about the abusive filings don't monitor the *Federal Register*, as New Jersey suggests, no amount of prior notice will prevent the abusive filings.

⁴ AAR claims that by limiting the Section 10901 and 10902 Exemptions to lines subject to the Board's "abandonment authority ensures that the line has been part of the national rail system." AAR Comments at 13. Section 10906 trackage, while not subject to the Board's abandonment jurisdiction, is as much part of the national rail system as are main lines and branch lines. *See* 49 U.S.C. § 10102 (6). Moreover, AAR ignores the fact a particular segment of track may be excepted track for one carrier but main line track for another.

New Jersey also acknowledges that the abusive filings are by new operators seeking new railroad services. As noted by New Jersey:

Where rail service already exists, local communities and other parties are already aware of those activities and may have little cause for concern simply because the service is being transferred to a new operator.

New Jersey Comments at 4.

New Jersey advocates actual, as opposed to constructive, notice and suggests that the Notices be filed on several state and local entities. New Jersey also recommends that the class exemptions be amended and restricted “so that they conform to the originally intended purpose – namely, to facilitate the transfer or restoration of bona fide rail common carrier service.” New Jersey Comments at 10-11. Finally, New Jersey suggests that certain additional information should be required in the Notices.

While New Jersey has made some noteworthy suggestions, overall they are much too broad and misdirected. If actual notice is to be given with the intention of preventing abusive filings, the notices need to be reserved for activities such as waste handling where the abuses are most likely to occur and not required in the run-of-the-mill filings. The notices also need to be directed to a few, select individuals that have the responsibility of monitoring potentially abusive filings with the Board. If no such individuals exist in a particular state, no useful purpose will be served sending a notice. By limiting the type of transactions that would require actual notice and by directing those notices to individuals responsible for the particular activity at the state and local level, the Board will be maximizing the chances that abusive filings will be caught before they become effective.

As previously noted, Watco does not believe it necessary to modify all of the Ten Exempt Transaction Types. Rather, only the scope of the Section 10901 Exemption needs to be

reexamined. Also, there is no compelling need to require additional information in the routine, legitimate filings.

As suggested by New Jersey, the Board should restart this effort of preventing abusive filings. Watco suggests that the Board and the railroad industry first identify the types of transactions that have resulted, or are likely to result, in a misuse of the class exemption procedures. Once those areas are identified, a more effective solution can be crafted. An effective solution may require all or some of the four elements suggested by New Jersey: a lengthier notice period, actual notice, redefining the scope of the Section 10901 Exemption and requiring additional information for those transactions that are likely candidates of abuse. The Board's overriding objective should be to adopt modifications to the Section 10901 Exemption which serve as an effective deterrent to abusive filings but which do not further burden or delay legitimate transactions.

In Watco's opinion, the suggestions made by AAR and New Jersey are overly broad and, as such, unlikely to be effective in deterring abusive filings. All legitimate transactions are treated as potentially abusive and thus they will all become more costly and suffer regulatory delay. The potentially abusive filings are not highlighted and thus will more likely go undetected before they become effective.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read 'Karl Morell', written over a horizontal line.

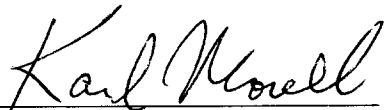
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Attorney for:
WATCO COMPANIES, INC.

Dated: June 14, 2006

CERTIFICATE OF SERVICE

I hereby certify that on June 14, 2006, I caused the foregoing Reply Comments of Watco Companies, Inc., to be served, by first class mail, postage prepaid, on all parties of record in this proceeding.


Karl Morell