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July 2, 2008

VIA E-FILING

The Honorable Anne K. Quinlan, Acting Secretary
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423-0001

Re: STB Finance Docket No. 35081
Canadian Pacific Railway Company, et al. – Control – Dakota, Minnesota &
Eastern Railroad Corp., et al.

Dear Secretary Quinlan:

The Kansas City Southern Railway Company ("KCSR") hereby files its Brief in the above-captioned matter. If there are any questions concerning this filing, please contact me by telephone at (202) 663-7823 or by e-mail at wmullins@bakerandmiller.com.

Sincerely,



William A. Mullins

Enclosures

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

FINANCE DOCKET. NO. 35081

CANADIAN PACIFIC RAILWAY COMPANY, ET AL.

- CONTROL -

DAKOTA, MINNESOTA & EASTERN RAILROAD CORP., ET AL.

BRIEF OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY

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Dated: July 2, 2008

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

FINANCE DOCKET. NO. 35081

**CANADIAN PACIFIC RAILWAY COMPANY, ET AL.
– CONTROL –
DAKOTA, MINNESOTA & EASTERN RAILROAD CORP., ET AL.**

BRIEF OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY

Pursuant to the procedural schedule in this proceeding as clarified in the Board's decision served on June 12, 2008, The Kansas City Southern Railway Company ("KCSR") hereby offers its brief ("Brief") in support of appropriate ameliorative conditions should the Board choose to approve the subject Application.¹ KCSR files its Brief in accordance with the Board's 20-page limitation, and on the understanding that "new evidence introduced on brief is not permitted and [if introduced] will be subject to motions to strike and other appropriate sanctions."² In keeping with the purpose of briefs in Board proceedings, KCSR will summarize its interest in this proceeding and the reasons it requests that the Board approve the Application only upon the condition that Applicants abide by specific ameliorative conditions. KCSR will also present its legal case showing once again why its proposed conditions are warranted and why they are consistent with agency precedent.

¹ Unless otherwise specified, the capitalized words, terms, and acronyms employed in this Brief are the same as those used and defined in the Application as filed in this proceeding on December 5, 2007. See KCSR Rebuttal at 4, n1.

² West Texas Utilities Company v. Burlington Northern Railroad Company, No. 41191 (ICC served Sept. 8, 1995), 1995 ICC LEXIS 236 at *4 ("[a] brief, as the name implies, is a short summary of the evidence of record and is not a vehicle for the introduction of additional or different evidence than that which is already of record. The purpose of a brief is not to give either side a tactical advantage by allowing it the 'last word;' it is to assist the Commission in evaluating the record ... so that it can make a fair and informed decision").

OVERVIEW

On March 4, 2008, KCSR filed its Comments and Request for Conditions (“Comments”) in this proceeding, stating that it did not oppose the Application, provided approval was subject to conditions addressing certain adverse impacts that would otherwise flow from Transaction. In requesting conditions, KCSR explained how the combined DME system functions as a neutral regional carrier and plays a critical strategic role in the interline movement of rail traffic moving in and through the Chicago, Kansas City, and Minneapolis/St. Paul gateways. KCSR offered two highly relevant illustrations of how DME’s interline neutrality inures to the benefit of shippers and receivers – the so-called “Grain Agreement”³ and the “Chicago Agreement”⁴ to which KCSR and IC&E are parties.

KCSR provided detailed evidence, including expert testimony from KCSR’s Michael R. Bilovesky and independent consultants George C. Woodward, Thad Jones, and Dr. Curtis Grimm to show that the Transaction will eliminate DME’s neutrality, resulting in higher rail prices for certain receivers and shippers. These witnesses clearly established that the proposed Transaction, if not conditioned, would give Applicants substantial economic and strategic incentive to control rail pricing and routings to the detriment of grain receivers in the south-central U.S. markets (who would have to pay more to obtain grain from other sources and suffer potential car supply problems) and would reduce competition in the important Laredo-Kansas City-Chicago corridor, eliminating one of the few remaining independent routes available to

³ The Grain Agreement gives KCSR ratemaking authority for the transportation of grain from IC&E-served origins in Iowa and Minnesota to KCSR-served destinations in the south-central United States (specifically, to KCSR-served points in the states of Texas, Oklahoma, Kansas, Missouri, Arkansas, Mississippi, Louisiana, and Alabama).

⁴ The Chicago Agreement grants KCSR pricing authority for rail service over IC&E’s route between Kansas City and Chicago for chemicals, forest products and other carload commodities.

compete against the Union Pacific Railroad Company (“UP”) who, in conjunction with CP and others, dominates the market in that corridor.

The potential harm to grain shippers and receivers was, and is, of particular concern to many shippers and government agencies. Ag Processing and the Southern Minnesota and Northern Iowa Shippers Association have urged the adoption of a condition and corresponding settlement agreement requiring CP to maintain open gateways and upgrade the infrastructure. The United States Department of Agriculture (“USDA”) has also recognized the potential harms and has urged the Board to ensure that grain receivers in the south-central U.S. retain the ability to utilize a DME/KCSR routing permanently, that there be no discrimination between KCSR and UP at the Kansas City gateway, that transit times be maintained, and that car supply issues be carefully monitored. USDA’s concerns, as well as those related to the NAFTA corridor, were also strongly echoed by Boise Cascade, LLC (“Boise Cascade”), MFA Incorporated (“MFA”), J.W. Nutt Company (“J.W. Nutt”), O.K. Industries, Inc. (“OKI”), Stepan Company (“Stepan”), and Tyson Foods, Inc. (“Tyson”), all of whom submitted statements urging the Board to condition its approval of the Application upon the conditions that KCSR has requested.

In their Reply filing on April 18, 2008, Applicants denied that the Transaction would give them an incentive to divert IC&E-originated grain to Pacific Northwest (“PNW”) destination markets or downgrade service to the Kansas City gateway, and disputed KCSR’s assertion that the Chicago Agreement (and the KCSR-IC&E interline relationship framing that agreement) provides meaningful competition in the Laredo-Kansas City-Chicago corridor. Applicants argued that – (1) they would lack the incentive and the ability to divert IC&E grain traffic to PNW export markets;⁵ (2) even if such grain diversions were to occur, there would no harm

⁵ While the Applicants were denying to KCSR and this Board that they could not divert IC&E grain to the PNW, Applicants were also obtaining letters of support from the very same IC&E

because KCSR-served grain receivers could receive grain from other sources at comparable prices, and (3) any adverse impact on competition resulting from cancellation of the Chicago Agreement and/or Applicants' future unwillingness to cooperate with KCSR for Laredo-Kansas City-Chicago interline traffic flows via Kansas City would be minimal.

KCSR filed its Rebuttal on May 19, 2008, refuting Applicants' Reply evidence and argument. KCSR's rebuttal evidence proved clearly that Applicants could earn more profit by routing IC&E originated corn to the PNW than by interchanging it to KCSR. Therefore, Applicants will have a strong economic incentive to price its rail routings and modify its service levels so as to discourage interline movements to KCSR-served grain receivers. KCSR also provided specific cost and pricing evidence to show that the KCSR-served grain receivers would in fact have to pay substantially higher rail and corn prices to obtain their corn from other sources. In addition, KCSR pointed out that Applicants effectively acknowledge that the Transaction would result in the reduction of independent competitive alternatives in the Chicago-Kansas City-Laredo corridor but downplay the overall impact of that loss. Ultimately, KCSR showed that Applicants have not made a satisfactory showing that approval of the Application – which in this case involves a “significant” Transaction under the Board's rules – would be in the public interest absent the conditions that KCSR is requesting.

THE CONDITIONS REQUESTED

The evidence and arguments summarized in the preceding section relate to the following two conditions that KCSR requests be imposed by the Board if it approves the Application:

1. The Board, much like it has done in other control transactions where it granted haulage, trackage, or other ratemaking authority to preserve competition, should ensure that KCSR has permanent pricing authority to serve the grain elevators located on the IC&E lines, and furthermore, during the remaining term of the Grain

shippers who were informed by Applicants that the Transaction would open up new markets for their grain, particularly to the PNW. See KCSR-3, R.V.S. Bilovesky at 20-24.

Agreement, Applicants should be required to maintain existing transit times through meaningful service protection provisions to ensure against deterioration of service for traffic handled under that agreement.

2. The Board should, at a minimum, ensure that KCSR has permanent haulage or other ratemaking authority over IC&E's Kansas City-Chicago line for the movement of all commodities in the Laredo-Kansas City-Chicago corridor and that there are meaningful service commitments and penalties to govern such an arrangement, including the rights to convert the haulage or pricing authority to trackage rights in the event service parameters are not met. KCSR is willing to negotiate such an arrangement provided that Applicants do so in good faith.⁶

ARGUMENT

As noted above, the Transaction, if not conditioned, will harm KCSR-served customers dependent upon economical access to IC&E-originated grain, and will harm competition in the Laredo-Kansas City-Chicago NAFTA corridor by eliminating a competitive alternative to UP's pronounced dominance in that lane. KCSR's previous filings established that the conditions it seeks are essential to preserve competition and are narrowly-tailored to ameliorate specific adverse impacts of the Transaction. Imposing these conditions would comport with applicable law and agency precedent.

I. THE BOARD POSSESSES THE AUTHORITY TO IMPOSE THE REQUESTED CONDITIONS

The Board has broad discretion to condition its approval of railroad control transactions.

See 49 U.S.C. § 11324(c). The Board has stated in a recent rail consolidation proceeding that:

In assessing transactions subject to § 11324(d), our primary focus is on the anticipated competitive effects . . . we may not disapprove the transaction unless

⁶ Negotiations should follow the structure and process used in the Union Pacific Corp., et al. – Control – MO-KS-TX, et al., 4 I.C.C.2d 409 (1988) (“UP-MKT”) proceeding (establishing the terms of KCSR's permanent access to grain sources in Lincoln, Council Bluffs, and Topeka), and as more recently prescribed in the Dakota, MN & Eastern, et al. – Control – Iowa, Chicago & Eastern, 6 S.T.B. 511 (2003) (“DM&E-IC&E”) proceeding (concerning DME's negotiation of operating rights over a segment of line that UP owned, and that DME operated, in Owatonna, MN). The Board should make clear that it will intervene as necessary in such negotiations to ensure that the parties are negotiating in good faith toward effectively implementing this condition.

the anticompetitive impacts outweigh the benefits and cannot be mitigated through conditions (which we have broad authority to impose under § 11324(c)).⁷

In KCS/TexMex, the Board added that “wherever feasible,” it will impose conditions “to ameliorate significant competitive harm” that would otherwise result from approval of the subject control transaction. Id. Agency precedent also states that the Board should exercise its conditioning authority to address the adverse impacts of a proposed transaction when it finds, as it should here, that the merging parties could gain sufficient market power to raise rates or reduce service (or both) relative to pre-merger levels, and to do so profitably.⁸ Moreover, 49 U.S.C. § 11324(c) gives the Board considerable latitude to address harms to the public interest that do not fall into any conventional category of harm to competition or to essential services.⁹

⁷ Kansas City Southern – Control – The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company, __ S.T.B. __, STB Finance Docket No. 34342, Dec. No. 12, slip op. at 15 (STB served Nov. 29, 2004) (“KCS/TexMex”) (emphasis added) (citing Canadian National Railway Company and Grand Trunk Corporation – Control – Duluth, Missabe and Iron Range Railway Company, Bessemer and Lake Erie Railroad Company, and The Pittsburgh & Conneaut Dock Company, __ S.T.B. __, STB Finance Docket No. 34424, Dec. No. 7 (STB served Apr. 9, 2004); DM&E-IC&E, 6 S.T.B. 511, 523 (2003); Canadian National, et al. – Control – Wisconsin Central Transp. Corp., et al, 5 S.T.B. 890, 899 (2001) (“CN/WC”); Kansas City Southern Industries, Inc., KCS Transportation Company, and The Kansas City Southern Railway Company – Control – Gateway Western Railway Company and Gateway Eastern Railway Company, STB Finance Docket No. 33311, slip op. at 4 (STB served May 1, 1997)).

⁸ See, e.g., CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company – Control and Operating Leases/Agreements – Conrail Inc. and Consolidated Rail Corporation (General Oversight), STB Finance Docket No. 33388 (Sub-No. 91), Dec. No. 6, slip op. at 7 (STB served Dec. 13, 2001); Union Pacific/Southern Pacific Merger, 3 S.T.B. 1030, 1046 (1998) (“[w]e have long defined harm that warrants merger conditions as that conferring on merging parties ‘sufficient market power to raise rates or reduce service (or both), and to do so profitably, relative to premerger levels’”); Burlington Northern Inc. and Burlington Northern Railroad Company – Control and Merger – Santa Fe Pacific Corporation and the Atchison, Topeka and Santa Fe Railway Company, 10 I.C.C.2d 661, __ (1995), 1995 ICC LEXIS 214, *139.

⁹ See Major Rail Consolidation Procedures, 5 S.T.B. 539, 569 (2001) (“Major Rail Consolidation”) (“[i]nstead of focusing narrowly on harm to competition and essential services, our new rule reflects a willingness to use our conditioning power to mitigate or offset all types of merger-related harms to the public interest”). Although the quoted language focuses upon “major” railroad consolidation policy, the authority under which the Board proposes to act –

Although the Board's Section 11324(c) conditioning authority may be described as a tool to protect against adverse impacts to competition and/or the loss of essential transportation services, the Board is not constrained to impose conditions only where a specific shipper at a specific station or point sees a reduction in the number of serving carriers from "2-to-1" or "3-to-2" or where essential services would be lost in the absence of Board action. Thus, although Applicants have espoused a limited reading of what constitutes competitive harm for which the Board should exercise its conditioning authority, the Board is not so constrained, nor should it be. Rather, as reflected in Major Rail Consolidation, the Board's overarching objective in exercising its conditioning authority is to protect the public interest by not only preserving competition, but enhancing it where appropriate, and ensuring that there is no diminution in service, transit times, or car supply.¹⁰

II. THE ADVERSE IMPACTS OF THE TRANSACTION WARRANT EXERCISE OF THE BOARD'S CONDITIONING AUTHORITY

The evidence of record confirms that the proposed Transaction will reduce competition and harm the public interest regardless of the fact that such harm does not fit within any specific label of harm.¹¹ KCSR has clearly shown that upon expiration of the Grain Agreement,

section 11324(c) – is the same statutory authority under which the Board may act in "significant" transactions.

¹⁰ Service and car supply are important issues that the Board has previously imposed conditions to preserve. See e.g. CN/WC, 5 S.T.B. at 897, 910-911, 919 (as a condition to approval of application, the Board held applicants to their pledge that shippers "will not suffer deterioration in the quality of rail service ... as a result of the control transaction," and that "service levels will be the same or improved," and further conditioned approval upon a one-time "equipment allocation and distribution report" designed to ensure that WC shippers did not experience a decline in access to quality railcars).

¹¹ Applicants criticize KCSR for not categorizing the competitive harm into a standard 2-to-1 or 3-to-2 paradigm, or for not detailing whether such harm constituted vertical, geographic, or source competition harm. The fact is that the type of competitive harm that the grain receivers and the Laredo-Kansas City-Chicago shippers will incur includes elements of all forms of competitive impact. Furthermore, there is nothing in the statute or the regulations that prevents the Board from imposing conditions to ameliorate the competitive impacts of a transaction

Applicants will have every incentive to raise rates or downgrade service on grain traffic moving from IC&E origins to KCSR-served destinations via Kansas City in order to encourage movements of IC&E grain to their more profitable long haul movements to the PNW, and that during the Grain Agreement, Applicants will likewise be motivated to downgrade service or de-market the IC&E-KCSR grain routings in order to favor the more profitable PNW routings. Likewise, Applicants will have the incentive and the immediate ability to reduce competition in the Laredo-Kansas City-Chicago corridor by increasing rates or reducing service for handling KCSR originated or terminated traffic moving through the Kansas City gateway in order to favor existing UP-CP routings in accordance with their alliance arrangements.

KCSR is not alone in urging the Board to institute appropriate conditions. As noted above, USDA has echoed KCSR's concerns about the potential harm to KCSR-served grain receivers should they lose cost-effective access to sources of grain supply on IC&E's Corn Lines. Boise Cascade, MFA, J.W. Nutt, OKI, Stepan, and Tyson have come forward to support KCSR's requests for conditions, sharing KCSR's concerns about the adverse impacts that would otherwise result from the proposed Transaction. The actual grain elevators on the IC&E Corn Lines likewise recognized the competitive impacts that could occur, and in response, demanded, and got, a settlement agreement that provides some very limited protections to ensure that the Kansas City gateway remained open.¹²

The United States Department of Transportation ("DOT") did not go as far as USDA or others in recognizing the competitive harm, although DOT does not say that such competitive

simply because the projected competitive harms do not fit neatly within generic categories of competitive harm.

¹² As discussed in KCSR's Rebuttal, Applicants' "open gateway" commitment does not adequately preserve the competitive options currently provided by a neutral DME. The commitment is overly vague, falls far short of previous commitments made by numerous other merger applicants, and does nothing to prevent disruptions in car supply or reductions in transit times and service. KCSR-3, at 47-50.

harms could not occur, only that the harm, if any, did not warrant KCSR's suggested conditions. In fact, DOT admits that the "merger may change the incentives of the parties" (DOT Reply Comments at 12), acknowledges that KCSR-served grain receivers could face increased costs as a result of the Transaction (DOT Reply Comments at 10), and recognizes that a KCSR-IC&E routing for NAFTA traffic to and from Chicago poses a potential counterbalance to UP's single-line service (Id. at 11). These statements clearly confirm the underlying premise of KCSR's concerns.

DOT's failure to support USDA's requests for conditions or those of the shippers and receivers who have expressed support for KCSR's proposed conditions seems somewhat at odds with DOT's prior positions in other recent Board proceedings. In the KCS/TexMex proceeding, for example, DOT was far more willing to propose and support conditions to protect against that transaction's possible adverse impacts even though DOT found that the KCS/TexMex transaction threatened "no significant public harms." KCS/TexMex, DOT Supplemental Comments (filed September 30, 2004) at 2. In that proceeding, stating concern over potential traffic diversions (just as are threatened here) under which BNSF Railway Company could be "shorthauled" (Id. at 3-4)(just as KCSR could be here) and the potential impacts to NAFTA traffic flows through the Laredo gateway (id. at 5-6)(just as this transaction threatens to reduce one of the few remaining independent routings in the Laredo-Kansas City-Chicago corridor), DOT recommended certain Board-imposed conditions.

DOT's studied caution in the KCS/TexMex proceeding (involving a "minor" transaction under the Board's rules) and advocacy for conditions despite a finding of no significant public harm seems incongruent with DOT's lenient view of the impacts of the proposed Transaction here. Regardless, DOT's filing nonetheless confirms the basic underlying premises of KCSR's argument – that CP will have different economic incentives than a currently neutral DME.

KCSR, USDA, and numerous shippers all believe that such impacts deserve conditions. Of the outside non-merging parties who have addressed these issues, DOT stands alone in refusing to support conditions.

The record evidence submitted by KCSR provides a detailed case for why and how the proposed Transaction would produce specific harms to specific shippers and receivers and to competition. Applicants, in turn, dispute KCSR's evidence (which KCSR has fully addressed in its Rebuttal), and argue, in the alternative, that the adverse impacts that KCSR has identified do not warrant any Board-imposed remedies. Missing from Applicants' Reply, however, is any explanation why, in light of the evidence compiled in response to the Application, which raises serious concerns about specific harms, the proposed Transaction (even without conditions) nevertheless, on balance, still warrants approval under Section 11324(d). Indeed, Applicants have failed to show that the proposed Transaction will not result in a reduction of competition. Applicants' competitive analysis has been extremely limited in scope and was inconsistent with competitive analyses conducted in other ICC/STB proceedings or by other agencies, such as the Federal Trade Commission or the U.S. Department of Justice. KCSR-3, R.V.S. Grimm at 2-8. In sum, there are ample grounds to reject the Application outright, but at a minimum, conditions should be imposed to remedy the adverse impacts of the Transaction.

III. EXERCISE OF THE BOARD'S CONDITIONING POWER AS KCSR HAS REQUESTED WOULD BE CONSISTENT WITH AGENCY PRECEDENT

Imposing conditions to ensure that competitive options remain in a post-transaction environment has been common practice. Often, such conditions come in the form of a grant of trackage rights allowing a non-merging railroad to physically access a shipper, station, or terminal to provide a pricing and service alternative to the newly merged railroad. Other forms of pricing and ratemaking authority, such as haulage rights, have also been imposed. See UP-MKT, 4 I.C.C. 2d 409 (1988)(imposing a condition to ensure that a non-merging railroad would

have ratemaking authority to the important grain origins of Omaha and Council Bluffs – such rights eventually being granted to KCSR in the form of haulage rights). Indeed, the agency regularly has exercised its Section 11324(c) authority to impose haulage rights conditions in merger cases.¹³ Haulage rights are very similar to the independent pricing authority sought here. Both arrangements permit the beneficiary carrier to price and market service directly to shippers on the incumbent (or host) carrier which provides the actual rail service to a designated point of interchange with the holder of the haulage rights and/or pricing authority. In fact, haulage rights can be regarded as a variant of independent pricing authority, just as trackage rights and haulage rights (though different on a variety of levels) are nevertheless seen as variant forms of remedy in rail merger cases.

Clearly the ratemaking authority proposed by KCSR here is similar in nature and scope to haulage rights, and certainly less intrusive than trackage rights. It is no different than that proposed and adopted in numerous other proceedings.¹⁴ The proposed conditions are based upon existing pricing and haulage agreements (the Grain Agreement and the Chicago Agreement) and the suggested conditions seek merely to maintain the competitive presence provided by those

¹³ See, e.g., Canadian National, et al. – Control – Illinois Central, et al., 4 S.T.B. 122, 153-4 (1999) (KCSR given haulage rights access to shippers at Geismar, LA); CSX Corp., et al – Control – Conrail Inc. et al., 3 S.T.B. 196 (1998) (“CSX/NS/Conrail”) (conditions extending haulage or trackage rights – at the discretion of the involved parties – to CP (over a former Conrail line between Selkirk and Fresh Pond, NY) and to the Wheeling & Lake Erie Railway Company (“W&LE”) (to reach interchange points with other carriers at Toledo and Lima, OH)).

¹⁴ For example, in granting conditions in favor of CP and W&LE in the CSX/NS/Conrail case, both carriers were given the option of exercising trackage rights or haulage rights. Numerous commenters in the Major Rail Consolidation proceeding depicted trackage rights, haulage rights, and reciprocal and/or terminal switching as the most common and effective remedies for the adverse impacts of railroad consolidations, effectively equating the three remedies. As KCSR recounted in its Comments, KCSR obtained haulage rights (convertible to trackage rights) to specific grain-originating points in Topeka, KS, Lincoln, NE, and Council Bluffs, IA via the merger proceeding in UP-MKT.

agreements. KCSR does not seek any new market access but simply to preserve the competitive landscape as it exists today.

Applicants maintain that the Board should nevertheless decline to impose KCSR's requested conditions as a matter of Board precedent. Applicants are likely, in their brief, to claim that KCSR has not identified any harms to "essential services" (meaning that KCSR will not go out of business as a result of the Transaction) or that there are no shippers who will see their rail routings reduced from "2 to 1" or "3 to 2." Thus, Applicants will argue that precedent and prior cases support the rejection of conditions here.

Applicants gloss over the fact that the Board evaluates each application on its own unique facts and in light of its specific impacts to the public interest, and that, accordingly, the Board's approach to imposing conditions is an inherently case-by-case undertaking.¹⁵ Applicants also gloss over the Board's newly stated policy that it will not focus only on harm to competition and essential services but is open and willing to using its conditioning power to mitigate or offset all types of merger-related harms to the public interest. See Major Rail Consolidation Procedures, 5 S.T.B. 539, 569 (2001). Although this is not a "major" merger, the policy implications are the same and the Board should apply its standards for imposing ameliorative conditions in view of its earlier finding that the proposed Transaction is "significant" and therefore must be subjected to an appropriate degree of scrutiny and caution.

Applying a case-by-case approach to this "significant" Transaction, there is no precedent rooted in the same facts as are present here which supports denial of the conditions KCSR has requested. For any such prior cases relied upon by Applicants to be of any guidance, they must reflect facts consistent with the following circumstances present here:

¹⁵ Cf. Major Rail Consolidation, S.T.B at 565 (if a Class II or III carrier can establish that competitive or other adverse impacts have resulted from a Transaction subject to Board approval, the Board may impose appropriate conditions on a case-by-case basis).

- There are identifiable groups of railroad customers (KCSR-served receivers of IC&E grain and shippers who benefit from the availability of the KCSR-IC&E routing in the Laredo-Kansas City-Chicago NAFTA corridor) that will, after the Transaction, either pay more to receive the same product or will lose an independent routing that competes against the CP/UP routing; and
- The harms to KCSR-served receivers of grain and to the shippers in the Laredo-Kansas City-Chicago rail service corridor would not occur but for the proposed Transaction (i.e., the conditions are not designed to remedy preexisting conditions).

The circumstances behind KCSR's request for relief are quite distinguishable from those in prior proceedings where parties sought to remedy pre-existing harms or to protect themselves from loss of traffic due to more efficient routings and were thus denied relief. Such is not the case here. There is no question here that it is the Transaction that creates the harm. Applicants acknowledge that the Transaction could result in diversions of IC&E grain to the PNW away from KCSR served destinations, and indeed have touted such as a benefit of the Transaction, but Applicants ignore that KCSR-served receivers will have to pay more to obtain their grain from other sources, an effect directly caused by the Transaction. Likewise, Applicants have also admitted that CP-UP routings for NAFTA traffic compete against IC&E-KCSR routings for that very same traffic, yet they downplay the loss of that routing.

In such similar circumstances, KCSR's examination of merger precedent has not disclosed any cases where the agency has declined to impose a remedy for transaction-related harms like those that would result here. Rather, the Board appears generally disinclined to impose conditions on a merger only where – (1) the complained of harm would likely occur regardless of the transaction; (2) shipper access to substitute sources or commodities made shipper harm unlikely; or (3) the record indicated that the harm to be remedied was unlikely to occur (or clearly would be outweighed by specific countervailing benefits). None of those circumstances are present here. The Board has the necessary flexibility to fashion conditions

that best address the proposed Transaction's impacts, and the Board has stated that it will "strive to remedy every competitive harm that would stem from any proposal that we decide to approve." Major Railroad Consolidation, 5 S.T.B. at 577. It should do so here.¹⁶

IV. PRESERVING THE SHIPPER'S CURRENT OPTION TO SHIP IC&E ORIGINATED GRAIN TO KCSR RECEIVERS WOULD AMELIORATE A SPECIFIC ADVERSE IMPACT OF THE PROPOSED TRANSACTION AND IS NARROWLY-TAILORED FOR THAT PURPOSE

Refusing to provide any of the standard commitments that merger applicants normally make in STB proceedings, Applicants insist that such commitments are unnecessary because the Transaction will have no anticompetitive effects. After opposition from IC&E grain elevators, KCSR-served shippers and receivers, KCSR NAFTA shippers, and USDA, Applicants had a change of heart, and are now offering a limited "open gateway" pledge. As KCSR has explained, however, such a commitment is vague and does not adequately protect against the adverse impacts of the Transaction that KCSR has identified. See KCSR Rebuttal at 42-47. KCSR has set forth in great detail how and why grain consumers on its lines will be harmed by the Transaction. Although the Grain Agreement has roughly 10 years remaining, KCSR has also explained that such a time frame is not particularly long when considered in terms of the

¹⁶ There are obvious parallels between the facts supporting conditions for aggregate producers in the CSX/NS/Conrail, 3 S.T.B. at 311-313 (imposing a condition to ensure that National Lime and Stone Company ("NLS") and Wyandot Dolomite ("Wyandot") did not lose access to traditional aggregate-consuming markets, including potential customers in those markets, by imposing certain run-through service and pre-blocking commitments) and the facts underlying KCSR's request for a condition linked to the Grain Agreement. In both cases, the conditions address the loss of efficient access to traditional markets and would preserve traditional traffic flows. Grain, like aggregate, is a plentiful commodity available from a number of sources, and, despite the fact that NLS and Wyandot customers presumably could obtain aggregate from alternative sources (although perhaps at higher cost), the Board nevertheless recognized the harm to the public interest that could flow from NLS's and Wyandot's inability to reach some of their customers after the transaction and imposed a condition. Likewise, KCSR's request for ratemaking authority in the Kansas City-Chicago corridor is fully consistent with the rights granted Tex Mex in UP/SP, 1 S.T.B. at 421-26, and like that case, would protect against reduced competition for NAFTA traffic by upholding KCSR's ability to participate in traffic moving between the Laredo gateway and the Chicago gateway, via Kansas City.

economic commitments that KCSR has made and must continue to make to ensure adequate service under the Grain Agreement.¹⁷ Interestingly enough, despite downplaying KCSR's concerns in this proceeding, CP expressed similar concerns in another proceeding, where it has requested (and explained the reasonableness of) a 20-year extension of a haulage agreement in which it participated, maintaining that such a condition was thoroughly reasonable. See CN-WC at 908.

Of course, any extension of the Grain Agreement, or any other continuation of KCSR's pricing authority to IC&E origins on the Corn Lines, would be irrelevant if Applicants can, without significant penalty, cause service to deteriorate to the point that KCSR customers lose effective access to IC&E grain origins. See KCSR Comments at 20-21, V.S. Woodward at 16-17, 20, 22. For this reason, KCSR's ability to provide ratemaking authority to IC&E grain elevators should not only be made permanent, but also, during the remaining pendency of the Grain Agreement, the Board should impose meaningful service standards (or require the parties to negotiate them) to bar Applicants from ever purposely allowing service to deteriorate. Moreover, KCSR urges that during the remaining term of the Grain Agreement the Board should require Applicants to report on service and transit times for Grain Agreement traffic as part of the Board's post Transaction oversight (or as an independent report if the Board orders no post-Transaction operational monitoring).

KCSR's request for permanent ratemaking authority to IC&E grain origins is narrowly-tailored and fits within the basic parameters of the existing KCSR-IC&E contract. The condition merely preserves the form and function of the interline service upon which KCSR customers

¹⁷ To support service under the Grain Agreement, KCSR has committed a fleet of locomotives and covered hopper cars and undertaken sufficient physical plant improvements to ensure the future efficiency of grain traffic flows – equipment and track material that KCSR explained has much more than a ten-year useful life and potential for return on investment. See KCSR Comments, V.S. Woodward at 12-13.

have come to depend, and would not expand the reach of the agreement or require Applicants to accept less economically advantageous terms. The condition would not interfere with Applicants' implementation of the Transaction, or undercut their objectives in undertaking it. It allows IC&E grain elevators the choice of where to best ship their corn rather than foreclosing their ability to ship to KCSR-served destinations, which an unconditioned Transaction would do. It also allows the receivers the choice to continue getting their corn from the IC&E origins via the most efficient route.¹⁸ The condition is narrowly focused on the harms it is designed to address, preserves the service status quo for KCSR customers and for IC&E-served grain originators, and it ensures important grain flow stability. It is therefore consistent with the Board's general expectation that a requested condition be carefully designed to address Transaction-related harms, rather than serve to confer a benefit upon a carrier or shipper.

V. PRESERVING KCSR'S RATEMAKING AUTHORITY IN THE KANSAS CITY-CHICAGO CORRIDOR WOULD AMELIORATE A SPECIFIC ADVERSE IMPACT OF THE PROPOSED TRANSACTION AND IS NARROWLY-TAILORED FOR THAT PURPOSE

The Board has long recognized the important trade policy objectives of NAFTA, as KCSR has explained in considerable detail in its Comments. The Board's decisions in other proceedings consistently reflect the agency's commitment to the principles underlying NAFTA. KCSR has also explained how its current system has been shaped by NAFTA and by the Board's own views on the importance of this agreement. Indeed, NAFTA and the trade objectives that it encompasses shape KCSR (and, to some extent, virtually every other carrier's) traffic flows, including those of alliance partners UP and CP.

¹⁸ The fact that IC&E-originated corn today represents the major source of supply for a significant number of KCSR feed mills, notwithstanding the ability to obtain corn from other sources via another joint-line route, e.g. CN-KCSR routing, shows that the IC&E-KCSR routing is the most cost efficient source of corn for these feed mills. Elimination of that routing choice will create inefficiencies for these feed mills and raise their delivered price.

Due to the need to maintain competition for NAFTA traffic, the independence of the IC&E-KCSR Laredo-Kansas City-Chicago routing must be preserved as a permanent alternative to the CP-UP routings for such NAFTA traffic. Applicants have claimed that there is no competitive harm or other injury to the public interest that would result from CP's repudiation of both the Chicago Agreement and the cooperative interline relationship that has been forged between KCSR and IC&E. They also claim that the present or future status of the Chicago Agreement has no relation to the Transaction. The record evidence shows that Applicants are wrong on both points.¹⁹

Although it is true that no traffic actually moves under the Chicago Agreement, KCSR has explained how the existence of the Chicago Agreement forms a framework around which IC&E and KCSR have been able to develop an important competitive alternative to UP's dominance in the Chicago-Kansas City-Laredo corridor and how elimination of that alternative routing would merely strengthen UP's dominance in such traffic flows. Applicants do not seriously contest that the IC&E-KCSR routing does provide an independent alternative for NAFTA traffic. Instead, Applicants contend that the KCSR-IC&E interline relationship at the Kansas City gateway is of such limited competitive significance that there is no harm in

¹⁹ The circumstances here are distinguishable from those in CN-WC proceeding, where CP asked for the extension of an unused haulage agreement with WC. The Board denied CP's request, finding that the combined CN/WC was no more likely to cancel the agreement than WC would be acting on its own. The Board added that the competition-preserving pledges volunteered by CN and a related agreement with NITL also should adequately address CP's concerns. CN-WC, 5 S.T.B. at 908. Here, KCSR has shown that CP is more likely to cancel the agreement than is DME because CP has an extensive alliance with KCSR's main competitor in that corridor -- UP. Likewise, the commitment to maintain an "open gateway" at Kansas City means nothing given the strong alliance between UP and CP and the lack of any pledge not to discriminate against KCSR vis-à-vis UP at the Kansas City gateway. Absent a condition, CP will simply choose to interline some of its NAFTA traffic with UP at Kansas City rather than at Chicago, and for other NAFTA traffic, avoid the Kansas City gateway altogether and continue with its existing CP-UP interchange at Minneapolis/St. Paul pursuant to its contractual and marketing relationships with UP.

eliminating that routing, but in so contending, they admit that the Transaction will in fact eliminate an existing competitive alternative, but then recommend no condition. Such a position runs contrary to the Board's stated policy to preserve competition as much as possible in any merger or control proceeding.

Indeed, a close analysis of the STB Waybill information (see Grimm R.V.S. Tables 1 and 2) establishes that there are only two possible routings in the Chicago-Kansas City-Laredo corridor that do not involve UP – an IC&E-KCSR routing and a BNSF-KCSR routing.²⁰ CP's acquisition of the IC&E route, standing alone, would not eliminate the independence of the IC&E(CP)-KCSR routing; however, the competitive impact of CP's acquisition of the IC&E Kansas City to Chicago line must be viewed in the context of CP's relationships with UP. CP has certain marketing and contractual relationships with UP that will result in it favoring a UP interchange, either at Chicago, Kansas City, or Minneapolis/St. Paul. It has no incentive (and may, in fact, have disincentives due to its relationship with UP) to work with KCSR in competition with UP in the Chicago-Kansas City-Laredo corridor.²¹ For those reasons, CP's acquisition of control of DME (and CP's ability to set prices for IC&E service) will thereby eliminate the neutrality and independence of the only existing viable alternative to UP in the Chicago-Kansas City-Laredo corridor. Thus, viewed in this context and in light of the UP relationship, the Transaction does result in a 2-to-1 reduction in competition in the Chicago-Kansas City-Laredo corridor.

²⁰ Due to the conditions imposed in the KCS/Tex Mex transaction, BNSF does not utilize a Kansas City interchange with KCS but rather moves its Chicago traffic to a KCSR interchange at Robstown or Corpus Christi.

²¹ The record clearly reflects that DME was willing to discuss both extending the Grain Agreement and revising the Chicago Agreement until CP, through public filings made at the STB, clearly indicated that CP would not favor such arrangements. It was shortly after those public filings by CP that DME abruptly halted negotiations and discussions. KCSR-2 at 22-26; KCSR-3 at 38, R.V.S. Bilovesky at 29-30.

For this reason and others expressed in KCSR-2 and KCSR-3, the Board should grant KCSR permanent ratemaking authority to the Chicago gateway over the IC&E Kansas City to Chicago line. Doing so is the only way to preserve competition in the movement of NAFTA-oriented traffic in that corridor. Just as with the Grain Agreement condition, the condition that KCSR seeks here is based upon the framework of an existing KCSR-IC&E agreement, would not enable KCSR to reach new markets, and does not secure for shippers benefits that they cannot and do not already enjoy as part of the existing neutral KCSR-IC&E relationship. As such, the condition that KCSR requests is not only appropriate in light of the Board's dedication to the principles of NAFTA, but it is also appropriately tailored to protect against specific Transaction-related harms.

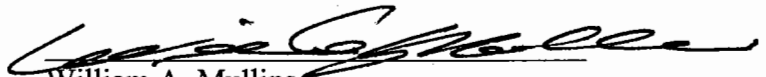
CONCLUSION

The record in this proceeding clearly establishes that certain KCSR-served grain receivers, who pay the actual freight charges at issue, will, after the Transaction, lose access to IC&E originated corn, which today represents the lowest delivered price of corn for many of these receivers. As a result, such receivers will have to seek alternative sources of corn, which, if available, will cost substantially more on a delivered cost basis than the existing IC&E sourced corn. Likewise, the evidence indicates that CP, upon acquiring control of the IC&E line between Kansas City and Chicago, will no longer have the same incentive as IC&E does today to work with KCSR to provide a competitive alternative to UP's dominance of NAFTA trade in the Laredo-Kansas City-Chicago corridor. Instead, CP, due to its contractual and marketing alliance with UP, will seek to interchange any such traffic with UP at Kansas City, Chicago, or Minneapolis/St. Paul. The result will be a reduction in independent competitive alternatives in the Chicago-Kansas City-Laredo corridor.

KCSR has shown that these adverse consequences of the merger are likely unless the Board, in approving the Application now before it, imposes appropriate ameliorative conditions. In this Brief, KCSR has highlighted the need for the conditions it seeks, demonstrated that such conditions are in the public interest, are consistent with prior agency precedent, and are narrowly-tailored to address the specific harms they would address. For these reasons, KCSR urges that the Board act upon the record evidence contained in KCSR's Comments and Rebuttal and impose the conditions that KCSR has requested in the event that the Board approves the subject Application.

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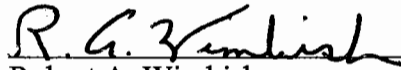
Attorneys for The Kansas City Southern
Railway Company

Dated: July 2, 2008

CERTIFICATE OF SERVICE

I have this day served a copy of the foregoing Brief Of The Kansas City Southern Railway Company upon all parties of record by depositing a copy in the U.S. mail in a properly addressed envelope with adequate first-class postage thereon prepaid, or by other, more expeditious means.

Dated: July 2, 2008

A handwritten signature in black ink, appearing to read "R. A. Wimbish", written over a horizontal line.

Robert A. Wimbish
Attorney for The Kansas City Southern
Railway Company