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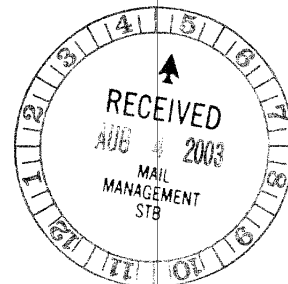
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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 34342

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



UNION PACIFIC RAILROAD COMPANY'S COMMENTS

VOLUME 1 of 2: NARRATIVE

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August 4, 2003

Contains Color Images

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Union Pacific Railroad Company ("UP") submits these comments on Kansas City Southern's ("KCS's") proposed common control of the Texas Mexican Railway ("Tex Mex"), Kansas City Southern Railway ("KCSR"), and Gateway Eastern Railroad (collectively "Applicants"), as well as its control of Transportación Ferroviaria Mexicana ("TFM"). In a separate volume, UP is submitting the verified statements of John T. Gray, UP's Vice President-Interline; Stephen R. Barkley, UP's Regional Vice President-Southern Region; Jerry Hausman, an MIT professor and leading industrial organization economist; and Francisco Fuentes Ostos, UP's Mexican counsel.

I. INTRODUCTION AND SUMMARY OF POSITION

KCS proposes to acquire control of the entire TFM rail system. The Board's conclusions here will determine the structure, routing, competitiveness, and vitality of rail-borne international trade between the U.S. and Mexico far into the future, probably for as long as railroads survive. In addition, the Board's handling of the international components of this transaction will affect the structure and course of all future transnational rail proceedings.

UP is not concerned about actions taken in Mexico. It is concerned about decisions that will be made and actions taken in the headquarters of KCS in Kansas City, Missouri, where KCS will exercise its control of Tex Mex and TFM. We ask the Board to consider the effects of this international transaction in the United States, not Mexico.

The Board should not doubt its authority and responsibility to review all potential effects of this transaction on international transportation affecting U.S. shippers. The NAFTA Rail proponents recently broke TFM's rail system into segments – for no reason that we can discern other than to restrict the Board's review of the transaction. But TFM before then had controlled a rail system stretching from Lázaro Cárdenas, Mexico, on the Pacific Ocean to Beaumont, Texas, hundreds of miles into the United States. If UP or BNSF sought to acquire control of CN or CP, and employed a similar device of splitting the Canadian railroad's U.S. operations into a separate transaction, the Board surely would not blindfold itself to the competitive effects in the United States of combining two of North America's major railroads. The Board should be equally vigilant here.

Although we are filing an extensive submission to satisfy the Board's call for substantial evidence, UP's position is simple. The Board should require Applicants to honor their commitments in a meaningful and enforceable way, and that requirement should be a condition of Board approval. Applicants have made several commitments to reassure the Board and the shipping community that NAFTA Rail will not harm competition for international rail traffic. KCS has agreed in writing to accept a condition requiring non-discrimination at the Laredo Bridge, and during the Board's July 31 hearing said it expects the Board to impose conditions requiring it to keep the Laredo Gateway open commercially as well. We agree with KCS that those commitments, if honored meaningfully, will prevent

adverse impacts on competition in the United States. As it has in all recent consolidation proceedings, the Board should hold the Applicants to their promises.

As we will show, relying on NAFTA Rail voluntarism to honor these commitments in the years and decades to come carries too much risk. NAFTA Rail's rational economic incentives will lure it away from those promises. Moreover, the risks to competition are real, while offsetting public benefits of the transaction are modest at best.

Public Benefits. KCS disavows most of the traditional public benefits of end-to-end consolidations. It claims no improvements in train service, no new run-through trains, no new blocking, and no cost reductions through consolidated facilities or functions. KCS, Tex Mex, and TFM rightfully brag that they already provide "seamless service." KCS makes much of its plans to extend its computerized operating system to Tex Mex and TFM, but KCS announced this step long ago and independently of this transaction.

KCS argues that this transaction will strengthen it financially, but that is doubtful, unless it uses the leverage from its new control over Tex Mex and TFM to shift substantial UP traffic to its lines and raise shippers' rates. To effect the transaction, KCS must take on hundreds of millions of dollars of additional debt. Its financial position is already weak, and the debt will not help. We assume that KCS's ultimate goal is to position itself for acquisition by another carrier.

Competitive Effects. If the Board were to accept KCS's recent statements at face value, the TFM transaction would have no effect whatsoever. KCS asserts that not a single shipper will reroute its traffic from UP routes to KCS's routes. Those assertions are not credible. Indeed, KCS has told the Board one story but given Wall Street another. KCS has told the financial community that it will use control over TFM to reroute U.S.-Mexico

traffic over its lines. Of course it will. NAFTA Rail may and should pursue its private interests using pro-competitive means, by improving rail service across the border and eliminating inefficiencies.

At the same time, however, NAFTA Rail will have the power to act anti-competitively. It could increase costs for its competitors, reduce the quality of service provided to competitors, and increase prices or reduce value to customers. NAFTA Rail will enjoy market power over significant flows of international traffic. The market power NAFTA Rail will possess arises in part from its control of the Laredo Gateway. A “gateway” is both a physical place and a set of commercial relationships, and NAFTA Rail will have a stranglehold on both.¹ It will have the power to control all movements over the International Bridge at Laredo, the physical gateway. And through TFM it will control the price and quality of all international traffic flows between Mexico and the United States via Laredo, the commercial gateway. With TFM, NAFTA Rail’s “share” of traffic moving via Laredo will be 100 percent. No traffic will be able to flow in either direction over that gateway without TFM’s cooperation on the total price and the quality of the international service.

This Board’s precedents establish that competition via the Laredo Gateway must be preserved and that other gateways and modes do not provide effective alternatives. The Board granted Tex Mex the right to connect with KCS over UP’s tracks on the basis of precisely this determination. Thus, NAFTA Rail’s very existence is founded on the essential

¹ As the map set forth as Exhibit A to Mr. Gray’s Verified Statement (“V.S.”) shows, and as Mr. Barkley and Mr. Gray explain, international traffic flows via Laredo must traverse *both* Tex Mex’s trackage across the Laredo Bridge and TFM’s network that serves the points in Mexico to/from which shippers need rail transportation.

competitive role of the Laredo Gateway. In the six years since the Board found the Laredo Gateway to be "of separate and surpassing importance to U.S.-Mexico rail transportation" and acted to avoid any reduction in competition there,² the Laredo Gateway has assumed even greater importance for NAFTA trade between Mexico and the rest of North America.

KCS claims that NAFTA Rail's economic interests will compel it to cooperate with UP and BNSF. That is so for those traffic flows for which KCS/Tex Mex cannot compete, such as movements to and from points served only by UP. The opposite is true for the majority of Laredo rail traffic, which KCS/Tex Mex could carry in the United States. *See Gray V.S., Exh. J.* NAFTA Rail will want to push traffic to its own routes unless the benefits of a competitor's route are compelling.

NAFTA Rail also will enjoy market power because of the continuing inability of Mexico to carry out the goals of rail privatization, initiated in 1997. Six years later, the two private railroads in the northern part of Mexico, TFM and Ferromex, continue to litigate rather than compete as foreseen by the privatization plan. As UP's Mexican counsel explains, the regulatory and legal structures in Mexico are unable to bring these conflicts to a close. More than twenty injunctions ("*amparos*") block regulatory decisions. Critically, the trackage rights fees for Ferromex to operate over TFM (and vice versa) are more than twice those used in similar situations in the U.S., and are commercially non-viable for almost all traffic. While the Board can do nothing to change that, it should

² *UP/SP*, 1 S.T.B. 233, 448 (1996). In that case, one of the Applicants here, Tex Mex, argued to the Board that U.S. policy regarding NAFTA required that the Board "give heightened scrutiny to transactions within its jurisdiction that present a danger of diminishing competition for transportation of U.S.-Mexican traffic." *UP/SP*, Brief of the Texas Mexican Ry. (TM-39) (June 3, 1996) at 17 (Exhibit 1).

understand that it cannot rely on competition within Mexico to alleviate the anticompetitive threat posed by this transaction in the United States.

One of America's leading economists, Professor Jerry Hausman, evaluates NAFTA Rail's economic power and its ability to use that power to harm the public interest. He asks the right question: not whether UP will be hurt (it will), but whether shippers would be hurt. He concludes that NAFTA Rail will have the incentive and the opportunity to extract higher prices and reduce the quality of service to shippers, unless KCS abides by the commitments it has made in the course of this proceeding.

KCS offers no analysis whatsoever of these competitive effects. Its economist declined to consider the vertical aspects of the NAFTA Rail transaction. However, his prior analysis of the same traffic flows confirmed that substantial amounts of U.S.-Mexico rail traffic are not subject to effective competition by other modes or gateways. In discovery, other parties sought information regarding competitive effects, including data in the possession of TFM (which KCS had a contractual right to procure). But KCS refused to provide such information, limiting UP's and others' ability to explore the most important issues in this proceeding. KCS should not now be allowed to remedy its failure and present evidence of competitive effects of the TFM transaction.

KCS's own commitments, if meaningfully enforced, would prevent the competitive harms likely to arise from the NAFTA Rail transaction. KCS commitments are as follows:

- To administer the International Bridge in a non-discriminatory manner.³
- To continue to support international service with BNSF and UP via the Laredo Gateway by providing blocking, run-through trains, car supply, competitive service, and prompt rate quotes.⁴
- To “keep the Laredo Gateway open on commercially reasonable terms.”⁵ If this means anything, it means that NAFTA Rail will ensure that TFM continues to offer commercially viable connecting rates for UP traffic moving via Laredo.⁶

³ Specifically, Applicants have committed to (a) “work cooperatively with UP toward efficient utilization of the Laredo Bridge” and (b) negotiate “in good faith with UP to develop new dispatching protocols.” Supplement to Application (KCS-11/TM-11) (“Supplement”) at 4, 26-27 & Davies V.S. at 15-16; *see also* Letter from William A. Mullins, Esq., to David L. Meyer, Esq., dated July 21, 2003 (filed with Board and served on all parties of record) (“Applicants’ July 21 Letter”) (Exhibit 2). Applicants have stated that they are willing to make their commitment “a condition of common control of Tex Mex.” Applicants’ July 21 Letter, p. 2.

⁴ Specifically, Applicants have committed to use KCS’s control of TFM to (a) ensure that “UP and BNSF are provided the same level of service they have experienced in the past, and to making improvements on that level of service where possible;” (b) “require TFM to cooperate with both UP and BNSF on pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars for shipment, accommodating run-through train service, providing excellent service and promptly quote rates;” and (c) “work with UP and BNSF on development of a methodology for measuring service standard, and to develop a method by which such standards could be enforced,” as to all traffic handled by TFM via the Laredo Gateway. Applicants’ July 21 Letter, p. 2 (Exhibit 2); Supplement at 4, 24-25 & Davies V.S. at 14-15.

⁵ Applicants’ July 21 Letter, p. 2 (Exhibit 2); Supplement at 4 & Davies V.S. at 15.

⁶ Keeping a gateway open means more than simply preventing physical impediments to the interchange of freight from one railroad to another at the point of interchange. It means ensuring that one railroad’s (here KCS’s) acquisition of another railroad on the other side of the gateway (here TFM) does not lead the acquired railroad to discontinue cooperating with other connecting carriers (here UP) on all of the commercial terms that go into competitive interline service offerings to shippers whose freight is moving across the gateway. Otherwise, the merged carrier can close the gateway “commercially,” making it

(footnote continued ...)

UP urges the Board to require KCS to honor these commitments in a meaningful and enforceable manner.⁷

We recommend a procedure under which interested parties would have 90 days to negotiate implementing agreements with KCS. If negotiations fail, the Board could resolve disputes, providing an unbiased final decision on any unresolved issues. KCS cannot complain about unfairness in being required to live up to its own promises, if those promises were honestly made.

Requiring KCS to abide by its commitments would not curtail the potential benefits of NAFTA Rail or NAFTA Rail's ability to compete. Non-discriminatory management of the International Bridge can only benefit the shipping public and international trade. Continued support of TFM routings with UP can only benefit competition and, again, promote trade. If NAFTA Rail can improve service and efficiency, it can attract new customers to its better service, or lower rates.

This is not a Mexican matter, as Applicants have suggested. The traffic at issue here is international cross-border traffic, and the benefit of that competition for shippers occurs primarily in the United States. The Board has consistently acted to protect U.S. shippers in precisely these circumstances. Lest there be a doubt about the appropriateness of Board action here, Applicants acknowledge that keeping this gateway

(... footnote continued from previous page)

impossible for the other connecting carriers' transportation options (here, UP-TFM options) to compete effectively for traffic moving via the gateway.

⁷ UP has heard from many of its shippers that they were less inclined to voice concerns about KCS's acquisition of Tex Mex and TFM in light of Applicants' commitments.

open is a matter of interest to “all affected parties.”⁸ And they have made their commitments – including commitments respecting KCS’s use of its control over TFM – in this U.S. proceeding.

Finally, Mexican sovereignty would be unaffected by enforcing KCS’s commitments. Mexican law, although difficult to enforce, is fully consistent with KCS’s promises. It requires non-discriminatory service and rates to all customers, including connecting carriers. Requiring NAFTA Rail management in the United States to honor its commitments with respect to TFM cross-border movements will not affect any regulatory power within Mexico.

Only this agency has the opportunity to evaluate and address the effects of this transaction on international rail commerce in the United States. Mexico’s Competition Commission acted on an ex parte basis and considered only effects within Mexico. This Board’s authority and remedial powers are much broader than those of the U.S. Department of Justice.

When the Board adopted new rules for Class I mergers, it fundamentally changed merger policy. Supported by UP and KCS, it decided that traffic flows over major, efficient gateways should be preserved. It also stressed the U.S. interest in ensuring that international transactions do not undermine rail competition for U.S. shippers. While those rules do not apply directly here, KCS’s commitments in this proceeding are faithful to those principles. The Board should require NAFTA Rail to stand behind these commitments.

⁸ Applicants’ July 21 Letter at 2 (Exhibit 2).

II. THE BOARD SHOULD CONSIDER THE EFFECTS IN THE UNITED STATES OF THE ENTIRE KCS/TFM/TEX MEX TRANSACTION

Consistent with its past practice, the Board should analyze the competitive effects in the United States of the entire KCS/Tex Mex/TFM transaction. To the extent the transaction threatens to produce anticompetitive effects in the United States, the Board should impose conditions that will mitigate those effects.⁹ Any other outcome would undermine the Board's authority to respond to future international rail consolidations, including mergers of U.S. and Canadian railroads.

Applicants have artificially segregated KCS's acquisition of control of Tex Mex for the Board's approval. The Board should not be deterred from exercising its full authority to review the effects of the entire transaction by KCS's strategy of segregating its acquisitions of Tex Mex and TFM. Before KCS's strategic use of a purchase and voting trust to temporarily insulate it from Tex Mex, TFM controlled Tex Mex. As the indirect owner of a railroad operating in the United States, TFM would be before the Board (as an applicant, with KCS) seeking approval for a KCS/Tex Mex/TFM transaction. The Board should reject any effort to limit its exercise of authority to review transactions in which carriers seek to acquire both U.S. and foreign rail assets through a strategy of restructuring corporate relationships.

Contrary to Applicants' assertions, considering the effects of the entire transaction and imposing conditions to mitigate any adverse effects are entirely consistent with Board precedent and principles of jurisdiction and comity. The Board plainly has

⁹ The governing legal standard, set forth in 49 U.S.C. § 11324(d), and in the Board's broad conditioning power under Section 11324(c), is discussed at pages 88-90, below.

jurisdiction to address effects on transportation *within the United States*, including international transportation. Imposing conditions to address any adverse effects on U.S. transportation would not intrude on the sovereignty of Mexico.

A. KCS's Acquisition of Control of Tex Mex and TFM Constitutes a Single Transaction

From its inception, the KCS/ Tex Mex/TFM transaction has been a cohesive transaction that will have significant impacts in the United States. Although TFM is a Mexican railroad, in March 2002 it acquired 100 percent of Mexrail. Mexrail is the holding company for Tex Mex, a railroad located entirely within the United States.¹⁰ Thus, KCS's acquisition of control of TFM, the indirect 100 percent owner of a railroad providing transportation in the United States, would normally be subject to the Board's jurisdiction.

However, just a few days before it filed the Application, KCS acquired 51 percent of TFM's Mexrail shares and placed them into a voting trust. In this manner, it removed TFM's controlling link with Tex Mex temporarily (until KCS could complete its acquisition of both, reuniting TFM with its 100 percent of Tex Mex).¹¹ KCS then insisted that only its acquisition of control of Tex Mex was subject to Board approval, since TFM no longer controlled a subsidiary that provided transportation in the United States. This was clearly an effort to evade Board jurisdiction by artificially breaking a single corporate family into separate segments, insulating TFM from its Tex Mex operations in the United States.

¹⁰ As the Application portrays, under TFM's "existing structure" (*i.e.*, prior to KCS purchasing 51% of Mexrail from TFM), TFM owned 100 percent of Mexrail and through it Tex Mex. Application at 13.

¹¹ TFM today continues to hold a 49% interest in Mexrail and Tex Mex.

While this purchase and voting trust strategy may have technically avoided the need for KCS and TFM to seek Board approval of the acquisition of TFM, it cannot oust the Board's authority to examine the effects of the entire KCS/Tex Mex/TFM transaction. Nor does it preclude the Board from fashioning conditions that would address any adverse effects on competition of KCS's acquisition of control of both TFM and Tex Mex. Nothing in the KCS purchase of Mexrail and placement of the shares in a voting trust changes the competitive impact of the entire transaction. It is simply an intermediate restructuring of corporate relationships. The effects of the transaction will be the same as if TFM still owned Tex Mex (indirectly through Mexrail).

It is inconceivable that the Board would permit any other U.S. Class 1 railroad to avoid agency review through the sort of maneuver KCS has engaged in here. If UP or BNSF were to announce plans to acquire control of CN or CP, parties would raise concerns about the effect of such a combination on competition both north and south of the border, as well as at the border. There would be questions about whether the merger partners would continue to offer commercially reasonable terms to connecting railroads or would attempt to foreclose competition through withdrawal of reasonable rate factors offered to connecting carriers at significant gateways. If UP or BNSF were to attempt to evade examination of such concerns about competition at international border gateways by carving off and acquiring the U.S. assets of its merger partner, then placing those assets in a voting trust, there would surely be vehement protests from both shippers and other railroads.

If the Board were to conclude here that KCS's purchase/voting trust strategy deprived the agency of the ability to consider the effects of the KCS acquisition of TFM in conjunction with its acquisition of Tex Mex, the result would be highly detrimental. The

message would be that parties to a transaction may evade Board jurisdiction by creative shuffling of assets and use of a voting trust. With the increasing NAFTA ties among the United States, Canada, and Mexico, there likely will be more cross-border transactions in the future. When that occurs, the parties will follow the road map laid out by KCS here. As a result, the Board would never again have the opportunity to review all the aspects of a transnational rail consolidation.

Despite the transparency of KCS's effort to artificially remove TFM from the Board's purview, Applicants assert that the KCS acquisition of control of Tex Mex is independent of its acquisition of control of TFM, and that either of the two "transactions" could occur independently of the other.¹² In fact, the KCS/Tex Mex/TFM combination was {{

}} and it was announced and explained to the public and the investor community as a single event.¹³

KCS's business people, and their financial advisers, have consistently described and analyzed KCS's acquisition of control of TFM and Tex Mex (through Tex Mex's parent Mexrail) as a {{

¹² See Reply to the Petition of Canadian National Railway Company to Reopen Decision No. 2 and to Reject Application (KCS-16/Tex Mex-16) at 14-15.

¹³ See KCS-Grupo TMM Press Release, April 21, 2003 (Exhibit 3).

}} KCS and Grupo TMM have consistently presented a single “NAFTA Rail Transaction” to the public, stressing that NAFTA Rail will be a single, seamless rail system.¹⁶

Given that Tex Mex is the critical link that connects the KCS and TFM systems,¹⁷ it is hard to imagine that KCS would embark upon the TFM acquisition as a stand-alone transaction without acquiring control of Tex Mex. Even if it did choose to delay acquisition of Tex Mex by divesting the 51 percent of Mexrail shares held in a voting trust, KCS might well gain effective control of both entities as soon as it completed its acquisition of TFM. KCS would own 100 percent of both KCS and TFM, the two connections on which Tex Mex depends the most, and through TFM 49 percent of Tex Mex. In these circumstances, even if KCS were to divest the Mexrail shares it has placed in a voting trust,

¹⁴ See Exhibit 4, p. 5. {{

}} *Id.* at 40.

¹⁵ For example, the {{

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¹⁶ KCS’s website (www.kcsi.com) includes various documents that consistently describe the “NAFTA Rail Transaction” as a single transaction. *See, e.g.*, “NAFTA Rail Transaction Summary” (available at <www.kcsi.com/pdf/nafta_rail.pdf>) (describing the series of agreements as a single “transaction” and analyzing the financial effects of a combination with “Grupo TFM consolidated”) (Exhibit 6).

¹⁷ *See* Exhibit 7 (KCS presentation characterizing Tex Mex as “a key link to the NAFTA Railway”).

the 49 percent indirect ownership of Tex Mex that it would acquire by virtue of its ownership of TFM likely would give it effective control of that carrier, thereby reuniting TFM and Tex Mex.¹⁸

The notion that the TFM and Tex Mex acquisitions are independent appears confined to the pleadings filed by KCS and Tex Mex in this proceeding. The Board was clearly correct when it concluded in Decision No. 2 that, “[n]otwithstanding that the two transactions nominally are separate and independent of each other, in reality they are two components of a single, larger transaction with broader implications in the U.S.” Decision No. 2, p. 11. KCS’s attempt artificially to separate TFM from Tex Mex operations for the duration of this proceeding and its characterization in its pleadings is no basis for the Board now to disregard those broader implications. Rather, the Board should analyze the effects of the entire transaction in the United States and develop conditions that are appropriate to remedy any adverse effects.

B. The Board Has Consistently Evaluated the Full Range of Effects in the United States from Proposed Transactions and Related Non-Jurisdictional Events

Because the KCS acquisition of control of Tex Mex is part of the larger KCS/Tex Mex/TFM transaction, the Board must examine the full range of effects of that larger transaction in the United States. There is no basis for segmenting the analysis and examining only one component of the overall transaction at a time.

¹⁸ See *Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. – Control – Chicago & North Western Holdings Corp. & Chicago & North Western Transportation Co.*, 9 I.C.C.2d 939, 947-48 (1993) (“UP/CNW-Control”).

In the past, the Board and its predecessor, the ICC, have examined effects associated with transnational mergers, so long as those effects relate to transportation in the United States.¹⁹ In one such transaction,²⁰ two Canadian carriers, Canadian National (“CN”) and Canadian Pacific (“CP”), sought ICC approval to purchase Conrail’s interests in three separate companies. The principal acquisition was of Canada Southern Railway Co. (“Canada Southern”), a Canadian carrier whose assets (a line from Windsor to Niagara Falls, Ontario, and various branch lines) were located entirely in Canada. The other two companies were the Detroit River Tunnel Company, which owned a tunnel at the Detroit/Windsor gateway that extended a very short distance into the United States, and the Niagara River Bridge Company, which owned a bridge at the Niagara Falls gateway that also extended a short distance into the United States. Despite the fact that one component of the transaction involved assets located entirely outside the United States, the applicants submitted the entire transaction for ICC approval.

The ICC concluded that, because the tunnel and the bridge extended for a short distance into the United States, it had jurisdiction “to the extent transportation in this country is involved.” *Canada Southern* at 8. The agency proceeded to analyze all aspects of the transaction, including claims involving the movement of international traffic on the Canada Southern lines in Canada. Among other things, it examined whether sale of the Canadian line would reduce competition in the Detroit-Niagara Falls/Buffalo corridor (for

¹⁹ Under 49 U.S.C. § 10501(a)(2), the Board’s statutory jurisdiction is defined in terms of “transportation in the United States.”

²⁰ *Canadian National Ry. & Canadian Pacific, Ltd. – Acquisition – Interests of Consolidated Rail Corp.*, ICC Finance Docket No. 30387 (ICC served Aug. 29, 1984) (“*Canada Southern*”).

which one route passed through Canada) and whether control of the Detroit and Niagara Falls/Buffalo gateways by CN and CP would adversely affect competition for U.S.-Canada traffic flowing across those gateways. The analysis included an inquiry into whether control of Canadian Southern would permit CN to discriminate against U.S. carriers by diverting traffic to its preferred gateway. *Id.* at 8-11. Ultimately, the agency approved the acquisition because it concluded that the *overall transaction* – including its Canadian components – would not have anticompetitive effects in the United States. *Id.* at 11.

Applicants point out that in *Canada Southern* the ICC declined to require CN and CP to enter into agreements with U.S. rail carriers because “the interchange practices of Canadian carriers in Canada are beyond our jurisdiction.” KCS-16/TM-16 at 14 (quoting *Canada Southern* at 7). However, the specific claim the ICC was addressing involved alleged refusal of Canadian carriers to enter into agreements with U.S. carriers for container traffic *between two Canadian points*, supposedly “forcing” the traffic to U.S. ramps. *Canada Southern* at 7. The Commission concluded that the claim was directed to problems that were “not related to this transaction.” *Id.* at 11. Moreover, the claim plainly related to competition in Canadian markets, not competition in the United States. Had the Commission found that the challenged practices were related to the transaction and had an adverse effect on transportation in the United States (not just in Canada), it likely would have come to a different conclusion regarding jurisdiction.

The Board also had no hesitation in considering the overall effects of a transnational merger in another proceeding involving a Canadian carrier.²¹ In its *CN/WC* decision, the Board considered the effect of a reduction from two shippers to one at Oba, Ontario (served by WC's subsidiary Algoma Central Railway, Inc., which operated only in Canada), and concluded that no U.S. shippers would face a merger-related reduction in competition for rail movements to or from Oba. *CN/WC* at 11 n.19. The Board considered aspects of the transaction in Canada to be relevant to the extent a reduction in competition might affect the United States.

In their Supplement, Applicants try to distinguish cases involving Canadian railroads. They argue that TFM is different because CN and CP have long operated under Board jurisdiction within the United States, whereas "TFM has never operated in the U.S."²² Applicants have very short memories. As noted above, until May 9, 2003, when KCS acquired 51 percent of the Mexrail shares and placed them into a voting trust as a part of this transaction, TFM's system extended into the United States through its 100 percent control of

²¹ See *Canadian National Ry, Grand Trunk Corp., & WC Merger Sub, Inc. – Control – Wisconsin Central Transportation Corp., Wisconsin Central Ltd., Fox Valley & Western Ltd, Sault Ste. Marie Bridge Co., & Wisconsin Chicago Link Ltd*, STB Finance Docket No. 34000 (STB served Sept. 7, 2001) ("*CN/WC*").

²² Supplement at 6.

Tex Mex.²³ Thus, just as CN and CP historically operated in the United States through their various U.S. subsidiaries, TFM has been operating in the U.S. through Tex Mex.²⁴

Applicants also attempt to invoke the older “one merger at a time” decisions (*see* KCS-16/TM-16 at 16-17). However, these cases are inapposite. They address whether the Board, when reviewing separate mergers involving *different sets of parties*, should consider the effects of one speculative merger while reviewing another.²⁵ The KCS/TFM transaction is clearly not some “speculative” event that may or may not happen. Indeed, Applicants have acknowledged that that transaction may already be consummated by the time the Board renders its decision in this proceeding.²⁶ More importantly, none of the cases Applicants cite comes close to addressing the question presented here: should two parties to

²³ In fact, Tex Mex has been a U.S. subsidiary of Mexican railroads since the early 1900s, when its stock was indirectly owned by Ferrocarriles Nacionales de Mexico. *See Mexrail, Inc. v. Union Pacific R.R.*, STB Finance Docket No. 32980 (STB served July 13, 2000) at 2 n.4.

²⁴ TFM has acknowledged that it participates in international traffic moving in the United States by virtue of participation in a car pooling agreement, and it has applied for and obtained authorization from the Board for its participation in that agreement. *See Transportation Ferroviaria Mexicana – Pooling of Car Service Regarding Multilevel Cars*, STB Finance Docket No. 29653 (Sub-No. 7) (STB served Sept. 28, 1999). Under 49 U.S.C. § 11322, the Board could have granted such approval only upon a finding that TFM was a carrier providing transportation within the Board’s jurisdiction.

²⁵ *See, e.g., Burlington Northern Inc. & Burlington Northern R.R. – Control & Merger Santa Fe Pacific Corp. & Atchison, Topeka & Santa Fe Ry.*, ICC Finance Docket No. 32549 (STB served Sept. 21, 1995) at 6. Moreover, KCS ignores that fact that the Board more recently has recognized that it is appropriate to depart from its “one merger at a time” principle in some circumstances. *See Major Rail Consolidation Procedures*, STB Ex Parte No. 582 (Sub-No. 1) (STB issued June 25, 2001) at 46. Here the Board properly called for Applicants to provide information about the TFM acquisition on the ground that the broader KCS/Tex Mex/TFM transaction could be very significant and that the role TFM plays in the U.S.-Mexico corridor is significant. *See* Decision No. 2, p. 10.

²⁶ *See* KCS-16/TM-16 at 14-15.

a transaction be permitted to avoid consideration of the overall effect of an international transaction by artificially bifurcating the jurisdictional and non-jurisdictional components?

In fact, the Board's consideration of aspects of an international transaction that involve transportation in the United States is simply a reflection of its regular practice of examining matters that, while they may not require approval, are nevertheless "related" to a transaction before the agency. For example, in the proceeding to approve the CN/Illinois Central ("CN/IC") control transaction, the Board considered the effects of an Alliance Agreement entered into by the applicants and KCS. It concluded that the agreement did not require regulatory approval, but, because it was "an important settlement agreement related to this merger, . . . it is appropriate for us to scrutinize carefully all of the issues relating to it that have been raised in this proceeding."²⁷

The Board made it clear in *CN/IC* that, even if a loss of competition arises from a non-jurisdictional arrangement related to the transaction formally under review, it is appropriate to consider those effects in connection with the transaction. Three shippers complained that another CN/KCS settlement agreement (the "Access Agreement") negotiated in connection with the control proceeding would result in loss of build-in/build-out opportunities.²⁸ The agency examined this allegation, noting that loss of such an option may "constitute a significant loss of competition."²⁹ The Board explicitly rejected CN's argument that the Board could not consider such a loss because it resulted

²⁷ See *Canadian National Ry., Grand Trunk Corp., & Grand Trunk R.R. – Control – Illinois Central Corp., Illinois Central R.R., Chicago, Central & Pacific R.R., & Cedar River R.R.*, STB Finance Docket No. 33556 (STB served May 25, 1999) ("*CN/IC*") at 25.

²⁸ *Id.* at 33.

²⁹ *Id.*

from a non-jurisdictional settlement agreement, explaining that the agreement was “clearly merger-related.”³⁰

Applicants recently invoked a decision involving UP and Chicago & North Western (“CNW”)³¹ for the proposition that the Board will look only to the “specific” transaction at issue. *See* KCS-16/TM-16 at 16-17. However, in evaluating UP’s agreement to purchase a sufficient amount of stock to gain effective control, the ICC stated that it would confine its consideration of the application “to the specific stock transaction *and related events*.”³² The Commission went on to make clear that other scenarios UP had presented were relevant to the analysis because they were indications of “what UP intend[ed] to do,” provided the basis for findings on the competition and public benefits issues, and therefore “must be considered” as part of the applicant’s operating plan.³³

The precedents discussed above make it clear that the Board’s longstanding practice has been to investigate transnational aspects of a transaction, including where pertinent activities that physically occur outside the United States, that may have an effect on transportation in the United States, and to examine matters “related to” a merger when analyzing effects of the merger. KCS’s acquisition of control of TFM has effects on transportation in the United States and is related to KCS’s acquisition of control of Tex Mex. The Board should have no hesitation in considering the effects of the entire KCS//Tex Mex/TFM transaction in the United States as part of this proceeding.

³⁰ *Id.*

³¹ *UP/CNW – Control*, 9 I.C.C.2d at 943.

³² 9 I.C.C.2d. at 949 n.14 (emphasis added).

³³ *Id.*

C. The Board May Fashion Remedies Addressing the Effects of the KCS/Tex Mex/TFM Transaction in the United States, Including Effects Arising from Its International Aspects

The Board may properly impose conditions that address any adverse effects of the KCS/Tex Mex/TFM transaction on transportation in the United States. This is particularly appropriate in the circumstances of this case, in which important NAFTA traffic flows are at stake. Moreover, Applicants have already made commitments involving TFM in recognition of effects that TFM's conduct will have on competition in the United States, and KCS's Mr. Davies stated at the July 31 hearing that Applicants expect that the Board will impose conditions in connection with those commitments.

The Board's precedents fully support the conclusion that the agency may impose conditions that address effects of a transnational transaction in the United States, even when those conditions will affect non-U.S. carriers and conduct outside the United States. For example, in the *CN/IC* proceeding, the Board imposed a merger condition in an effort to protect international traffic flows, despite the fact that its condition affected an Ontario partnership, owner of the Detroit River Tunnel Company. The Board considered a claim by CP and another party that, due to CN's new investment in IC, CN would be less inclined to allow needed improvements to the Detroit River Tunnel ("DRT"). Their argument was that CN would have a stronger incentive to impede the flow of CP's cross-border traffic in order to shift traffic to CN lines in Canada and the United States.³⁴ The Board concluded that the protesting parties had failed to demonstrate a significant causal link between the transaction and the pre-existing DRT situation. It nevertheless imposed a

³⁴ *CN/IC* at 34-35.

condition holding applicants to their representation that they would not use their control of the Detroit River Tunnel Company – through the Ontario partnership – to frustrate necessary improvements to the tunnel, “because of the importance of the DRT to international trade.”³⁵

In the *CN/WC* proceeding, which involved a minor transaction, the Board declined to impose the terms of an agreement between CN and the National Industrial Transportation League (“NITL”) as a condition to approval of the transaction because doing so did not appear necessary to remedy adverse consequences of the transaction.³⁶ However, the Board did state that it would hold applicants to representations they had made about the meaning and reach of the agreement.³⁷ The NITL/CN agreement included interchange protection provisions that included, among other things, a commitment by CN/WC to establish and maintain “commercially reasonable contract through rates and charges” for traffic originating in or destined to points on the Wisconsin Central system over any existing interchange between Wisconsin Central and another carrier.³⁸ This commitment covered all of the North American rail carrier subsidiaries of Wisconsin Central Transportation Corporation, including Algoma Central, which operated only in Canada.³⁹ Thus, the Board held the applicants to a commitment regarding rates they would charge for transportation that occurred in part within Canada.

³⁵ *Id.* at 35.

³⁶ *CN/WC* at 12.

³⁷ *Id.*

³⁸ *Id.* at 34.

³⁹ *Id.* at 3 n.3; *see also* NIT League-CN Settlement Agreement (Exhibit 8).

Of course, the rate context is one in which the Board has long awarded relief that extends across national boundaries. It is well established that the Board may assess the reasonableness of joint rates involving a domestic carrier and a foreign carrier, even though its remedial powers do not extend directly to the foreign carrier. In such cases, the Board orders relief for an unreasonable international through rate against the United States carrier participating in the route, even though the agency lacks jurisdiction over the foreign segment of the through route and rate.⁴⁰ The Board “remains free to take corrective action such as assessing reparations from domestic U.S. carriers participating in such rates.”⁴¹

In this case, requiring KCS, as a condition to Board approval of the Tex Mex transaction, to agree to use its control of all NAFTA Rail carriers (including TFM) to cause TFM to refrain from certain practices that would have anticompetitive effects in the United States would be entirely appropriate and consistent with past practice. The Board has previously emphasized the importance of protecting NAFTA flows.⁴² The conditions UP proposes – aimed at fair treatment for U.S. carriers using the Laredo Bridge and keeping the

⁴⁰ See, e.g., *Great Northern Ry. v. Sullivan*, 294 U.S. 458 (1935); *Canada Packers, Ltd. v. Atchison, Topeka & Santa Fe Ry.*, 385 U.S. 182, 183-84 (1966).

⁴¹ *Canadian Pacific Ltd. v. United States*, 379 F. Supp. 128, 134 (D.D.C. 1974).

⁴² For example, in *UP/SP*, 1 S.T.B. at 421, the Board stated:

“We are particularly sensitive to our responsibility to ensure that this merger will foster the goal of North American economic integration embodied in NAFTA. After all, our regulatory powers are derived from the “Commerce Clause” of our nation’s constitution, which, in a very real sense, has resulted in the creation of a “free trade zone” within these United States, leading to our emergence in this century as an economic superpower.”

Laredo Gateway open – are all directed at preserving competition and efficiency for NAFTA traffic flows. They would not pertain to TFM’s transportation of rail traffic solely between points within Mexico. As explained in later sections, in order to preserve competition at the vital Laredo Gateway and to avoid anticompetitive effects north of the border for U.S.-Mexico traffic movements, BNSF and UP require cooperation from TFM on international interline shipments on commercially reasonable terms, as KCS has promised.

Remedying effects arising out of KCS’s acquisition of control of TFM (in combination with its acquisition of control of Tex Mex) is particularly appropriate here. Applicants have already made commitments to the Board and to other parties in this proceeding regarding their intention to treat other carriers fairly in operation of the Laredo Bridge, to keep the Laredo Gateway open on commercially reasonable terms, and to avoid discrimination against connecting carriers.⁴³ In testifying at the Board’s hearing on July 31, 2003, in this proceeding, Mr. Davies of KCS stated specifically that KCS expects that the Board will impose a condition involving preservation of commercially reasonable access to the Laredo Gateway. Because Applicants have already conceded the appropriateness of such commitments, there should be no objection to the Board’s imposition of conditions ensuring the enforceability of those commitments.⁴⁴

⁴³ Applicants’ July 21 Letter (Exhibit 2).

⁴⁴ See, e.g., *CN/WC* at 8, 12 (Board will “hold applicants to representations they have made in this record about the meaning and reach of [the applicants’ settlement agreement], including applicants’ pledge not to “engage in vertical foreclosure by closing efficient gateways”).

D. Imposing Conditions to Remedy Adverse Effects of the KCS/Tex Mex/TFM Transaction on Transportation in the United States Would Not Violate Principles of Jurisdiction or Comity

Applicants have suggested that imposing conditions relating to effects of KCS control of TFM and Tex Mex would somehow exceed the Board's jurisdiction and violate principles of comity. This is not the case.

UP is not asking the Board to assert "extraterritorial jurisdiction." We anticipate that the Board would impose any condition not to TFM or any other Mexican entity, but on a U.S. entity – KCS – over which the Board clearly has jurisdiction. Such conditions would be directed at NAFTA Rail management decisions made in the United States, in Kansas City, Missouri. Most importantly, the conditions would affect movements into and out of the United States and commercial arrangements relating to those movements (*e.g.*, establishment of origin-to-destination rates for U.S.-Mexico cross-border shipments). UP is concerned with any effects of the entire transaction on transportation *in the United States, i.e.*, on competition north of the border. The Board would order KCS, a U.S. Applicant, to negotiate with other parties and ultimately to exercise its control over TFM to cause it to refrain from conduct that would adversely affect competition north of the border.⁴⁵

⁴⁵ Of course, it is well established that U.S. law can apply to foreign economic actors to the extent that the effects of their conduct are felt in the United States. For example, in *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 796 (1993), the Supreme Court upheld the applicability of the U.S. laws to London-based insurance companies and stated that "it is well established by now that the Sherman Act applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States." Based on this "effects test," the U.S. antitrust agencies routinely review proposed mergers involving foreign companies, and routinely impose conditions on such mergers. *See, e.g.*, FTC Press Release, "FTC Accord in Ciba Geigy/Sandoz Merger to Prevent Slowdown in Gene Therapy

(footnote continued ...)

Nothing in the conditions UP seeks would violate Mexican sovereignty in any way. No Mexican agency has the power to redress anticompetitive effects in the United States. No Mexican agency has even looked at that subject. What UP is proposing here is merely prescription of concrete steps to accomplish broad commitments that KCS has already made. These steps – negotiation of dispatching protocols requiring fair treatment of carriers using the Laredo Bridge, avoiding discrimination against UP on matters of service, and providing commercially reasonable terms for through movements over the Laredo Gateway – would not require KCS to order TFM to violate any Mexican law or regulation. *See Fuentes V.S.* at 9-10.

Applicants have also suggested that the Board should refrain from considering the overall effects of KCS's acquisition of TFM and Tex Mex because other regulatory bodies have some role in reviewing the TFM portion of the transaction. KCS-16/TM-16 at 11-12. The Board should reject this suggestion. The issue in this proceeding is the effects of the transaction on highly significant rail traffic flows into and out of the United States at the most important rail gateway on the U.S./Mexico border. The fact that other agencies are also reviewing the transaction (or have already reviewed it) does not suggest that the Board should relinquish its authority to examine effects of the transaction in the United States. No Mexican body will be concerned with competition north of the border. The fact that other agencies with different responsibilities review this transaction should not

(... footnote continued from previous page)

Development & Preserve Competition in Corn Herbicides, Flea-Control Markets” (Dec. 17, 1996) (<<http://www3.ftc.gov/opa/1996/12/ciba.htm>>) (describing settlement agreement requiring two Swiss pharmaceutical companies to undertake substantial divestitures of foreign assets).

deter the Board from taking appropriate action to safeguard competition in the United States. Certainly no Mexican agency is in a position to regulate in this area. *Fuentes V.S.* at 7-9.⁴⁶

We briefly review the status of the three investigations Applicants to which Applicants have alluded.

Mexican Competition Commission

As Applicants report, the Mexican Competition Commission (the Commission Federal de Competencia (“CFC”)) decided not to block KCS’s acquisition of TFM under Mexico’s competition law. However, this action does not indicate that the transaction will have no anticompetitive effects on U.S.-Mexico cross-border traffic or within the United States. CFC expressly limited its analysis to the competitive situation *within* Mexico. It considered only an intra-Mexico market, defined as {

} CFC apparently viewed the transaction as {

} The CFC decision included no analysis of effects on international transportation, or effects of NAFTA Rail control of TFM on competition within the United States. Thus, the decision has no bearing on the issues that this Board must determine.

⁴⁶ The Board has recognized that Canadian and Mexican authorities will be reviewing proposed transnational railroad combinations simultaneously with the Board’s review. *See* 49 C.F.R. § 1180.1(k)(2).

⁴⁷ *See Fuentes V.S.*, Exh. A (KCS-C-0188).

⁴⁸ *Id.* at KCS-C-0189.

Moreover, CFC's review was performed on an *ex parte* basis, without allowing participation by parties other than KCS/TFM. The CFC rejected Ferromex's comments, apparently based on a belief that Mexican law precluded it from considering the views of other parties.⁴⁹ Even after limiting its analysis, CFC voted to approve the transaction on a tie vote (2-to-2). Under CFC procedures, the vote of a commissioner who supported the transaction was counted as the tie-breaking vote. Fuentes V.S. at 7-8.

U.S. Department of Justice

UP understands that KCS and/or Grupo TMM made Hart-Scott-Rodino notifications pertaining to KCS's acquisition of TFM, and that the statutory waiting period has expired. However, the agency that would have reviewed the transaction was aware that the Board is conducting its own review of the transaction, and that the Board (in Decision No. 2) has expressed its intention to consider the competitive effects of KCS's acquisition of both TFM and Tex Mex. Given DOJ's limited enforcement resources, its limited enforcement options relative to the Board's broad remedial authority,⁵⁰ and its awareness of the Board's pending proceeding, it should not be too surprising that DOJ did not take action regarding the TFM acquisition. Whatever action the Board chooses to take in this case will not create a conflict with DOJ's disposition of the matter.

⁴⁹ UP attempted to participate in the CFC proceeding, but, pursuant to the CFC's standard operating practices, it refused to consider submissions by parties other than KS/TFM. Fuentes V.S. at 8.

⁵⁰ Unlike the Board, DOJ has no power to impose competition-preserving conditions. It must secure the parties' agreement to a consent decree or sue in federal court to enjoin the transaction.

Mexican Foreign Investment Commission

As Applicants note, KCS's acquisition of TFM is also subject to review by Mexico's Foreign Investment Commission ("FIC"). FIC is charged with considering whether control of TFM "would contribute to increasing the competitiveness of Mexican industry and promoting regional and technological development, and protect the sovereign integrity of the Nation. The primary focus of this inquiry is on "internal Mexican economic matters." Fuentes V.S. at 8. FIC's review is ongoing, and the precise scope of its inquiry remains unclear. Whatever the outcome of that review, however, it will not involve any evaluation of the effects of KCS control on competition in the United States.

* * *

Thus, there is no jurisdictional bar and no principle based on comity that precludes the Board from analyzing the effects of the entire KCS/Tex Mex/TFM transaction in the United States or from imposing conditions to remedy any adverse effects. The Board is the only agency that is in a position to address the effects of the overall transaction on transportation in the United States. It should proceed with this analysis and, on that basis, impose conditions that will make concrete and effective the commitments Applicants have previously stated in this proceeding.

III. UNCONDITIONED KCS CONTROL OF TEX MEX AND TFM WOULD RESULT IN SUBSTANTIAL LESSENING OF COMPETITION IN THE UNITED STATES

Under 49 U.S.C. § 11324(d), the Board's focus in this case is on competition. UP recognizes that the Board must "approve the transaction" unless it finds there is a likelihood that it will cause a "substantial lessening of competition" that cannot be overcome through conditions without sacrificing public interest benefits stemming from the

transaction.⁵¹ This transaction likely will have such an effect, unless the Board exercises its broad power under 49 U.S.C. § 11324(c) to impose conditions that protect competition. As we explain below, the Laredo Gateway plays a uniquely important role in U.S.-Mexico rail transportation, for which competition among U.S. carriers north of the border provides significant benefits. KCS control of Tex Mex and TFM will give it control of all U.S.-Mexico traffic moving across this vital gateway. Unless Applicants' conditions are implemented by the Board in meaningful and enforceable ways, KCS will use its control to cause anticompetitive shifts of traffic from UP-TFM routes to KCS/Tex Mex routes, degrading services provided to shippers and raising rates.

A. The Laredo Gateway Is Vitrally Important to U.S.-Mexico Rail Transportation

The gateway at Laredo, Texas, where Tex Mex and TFM connect, is at the center of this case. The Board has long recognized the vital importance of the Laredo Gateway for competition in the United States.

1. The Board's Grant of Trackage Rights to Tex Mex in *UP/SP* Was Predicated on a Finding that Rail Competition Via the Laredo Gateway Must Be Protected

In 1996, the Board concluded that Laredo was "the most important U.S.-Mexican rail gateway,"⁵² occupying a position of "separate and surpassing economic

⁵¹ See *Kansas City Southern Industries, Inc., KCS Transportation Co. & The Kansas City Southern Ry. – Control – Gateway Western Ry. & Gateway Eastern Ry.*, STB Finance Docket No. 33311 (STB served May 1, 1997) at 4 (if the transaction is likely to cause a substantial lessening of competition, Board may approve the transaction only "if the public interest benefit outweighs any anticompetitive impact that cannot be mitigated through conditions").

⁵² *UP/SP*, 1 S.T.B. at 422.

significance” in U.S.-Mexico commerce.⁵³ These conclusions were based in significant part on Tex Mex’s representations to the Board that:

“Laredo is the principal gateway for rail traffic between the United States and Mexico. A majority of all rail traffic moving between the United States and Mexico moves over this gateway. Of all the U.S.-Mexico rail border crossings, it is supported by the strongest infrastructure of customs brokers and provides an effective routing in Mexico to the major Mexican destinations.”⁵⁴

Based on these representations and the Board’s own findings, the Board granted extensive trackage rights to Tex Mex in order to ensure that there was no reduction in rail competition for rail traffic moving via Laredo.

The Board justified this grant based on the need to “ensure the continuation of an effective competitive alternative to UP’s routing into the border crossing at Laredo.”¹ S.T.B. at 424.⁵⁵ The Board defended its action in the Court of Appeals on the same basis, explaining that it was “undisputed that the merger without conditions would have resulted in significant competitive harm south of Houston, particularly in the U.S.-Mexico trade over the important Laredo gateway, which is used only by UP and Tex Mex.”⁵⁶ Unless the Board

⁵³ *Id.* The Board also found that that Laredo was “the premier Eastern Mexico gateway,” in part because it was the “most efficient Mexican rail gateway” and in part because of its “excellent infrastructure and customs facilities.” *Id.* at 565, 566.

⁵⁴ *UP/SP, Responsive Application of The Texas Mexican Ry. (TM-23)* (Mar. 29, 1996) at 8-9 (Exhibit 9). Similarly, in this case, Applicants acknowledge that Laredo’s importance is “due to [its] superior infrastructure, such as customs brokers, and its location on the shortest route between major Mexican industrial and population centers and the Midwest and Eastern U.S.” *Application, Grimm V.S.* at 84.

⁵⁵ *See also UP/SP, Houston/Gulf Coast Oversight*, Decision No. 10 (STB served Dec. 21, 1998) at 10 (noting that Tex Mex’s trackage rights over UP were designed to address “the potential loss of competition at Laredo”).

⁵⁶ *Western Coal Traffic League v. STB*, No. 96-1373, Brief of Respondent STB (Dec. 1997) at 46 (Exhibit 10). The Board defended the grant of Tex Mex’s trackage rights as

(footnote continued ...)

were to conclude in this case that there have been “substantially changed circumstances”⁵⁷ – in which case the justification for a continuation of Tex Mex’s trackage rights would evaporate – it would be impossible for the Board to find there are sufficient alternatives to rail transportation via Laredo (*e.g.*, alternative gateways or modes) to put aside the concern for protecting rail competition at this vital gateway.

2. U.S.-Mexico Rail Shippers Overwhelmingly Prefer Routes Via Laredo

As important as Laredo was in 1996, it is even more important today. The volume of traffic moving across the Laredo Gateway has more than doubled since 1995, as shown in Exhibit F to Mr. Gray’s verified statement.⁵⁸ Strengthened by the Board’s grant of trackage rights in *UP/SP*, Tex Mex has increased its own Laredo Gateway volumes three-and-a-half fold since 1995. *Id.*⁵⁹

Laredo’s importance relative to other border gateways is striking. More than 75 percent of all U.S.-Mexico rail traffic (by dollar value) crosses the border at Laredo. Gray V.S. at 10. Laredo’s share of aggregate U.S.-Mexico rail commerce understates its importance. Basic geography makes the three gateways in western Mexico – Calexico, Nogales and El Paso – unacceptable alternatives to Laredo for most of the rail traffic flowing between the central and eastern United States (and Canada) and the most populous

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“preserv[ing] a limited role for Tex Mex in providing part of an alternate route for shipments moving to and from Mexico.” *Id.* at 46-47.

⁵⁷ 49 C.F.R. § 1115.4.

⁵⁸ See Gray V.S. at 12 & Exh. F.

⁵⁹ See also Gray V.S. at 12.

and industrialized regions of Mexico. Those gateways are for the most part limited to handling traffic moving between the western United States and points in western Mexico.

Id.

Of the three eastern Mexico gateways – Laredo, Eagle Pass/Piedras Negras, and Brownsville/Matamoros – Laredo’s share is by far the largest. In 2002, Laredo handled over 75 percent of the rail traffic (by dollar value), and over 50 percent of the rail carloads, that crossed the border at these three gateways.⁶⁰ The principal alternative to Laredo is Eagle Pass/Piedras Negras, where UP and BNSF connect with Ferromex.⁶¹ Laredo handles more than three times the volume of traffic crossed at Eagle Pass, and Laredo’s share continues to grow.⁶²

Perhaps even more telling is the share of *UP’s* traffic moving via Laredo. Despite having acquired a 26 percent equity interest in Ferromex in 1997, UP’s cross-border traffic has shifted increasingly *toward the Laredo Gateway*, because shippers demand the benefits that Laredo offers. In 1995, Eagle Pass accounted for { } percent of UP’s (and

⁶⁰ Gray V.S., Exh. D.

⁶¹ Brownsville/Matamoros is of very limited importance. Because of geography, inferior infrastructure and other factors, Brownsville is used principally for traffic moving between the United States and Mexican points just across the border from Brownsville, and for the routing of empties to relieve congestion at Laredo. It does not offer an effective substitute for routes via Laredo. In any event, Brownsville provides a connection only with TFM and no competitive alternative. Gray V.S. at 11.

⁶² In 1995, Laredo accounted for { } percent of the total cross-border rail traffic at these two gateways. By 2002, Laredo’s share had grown to { } percent. *See* Gray V.S. at 12 & Exh. F.

SP's) total cross-border traffic at the Laredo and Eagle Pass gateways.⁶³ By 2002, Eagle Pass's share of UP's traffic moving via these two gateways had fallen to only { } percent.⁶⁴

Even these impressive statistics mask the true importance of the Laredo Gateway, because they focus on aggregate U.S.-Mexico flows. Examining individual state-to-state flows reveals even more clearly shippers' overwhelming preference for Laredo. For movements between the central and eastern portions of the United States and Canada, on the one hand, and the Mexican states in the industrialized heartland of northeastern and central Mexico that are served by TFM's superior route network, on the other hand, the share of traffic moving via Laredo is in many cases well in excess of { } percent. *See Gray V.S. at 11-12; Hausman V.S. at 7 & Exh. B.*

3. The Laredo Gateway Offers Important Advantages for Shippers

As John Gray, UP's Vice President-Interline, explains in detail, Laredo has several attributes that account for its preeminent role in cross-border rail transportation:

First, as a result of extensive investments over many years by the railroads serving Laredo and by governmental agencies and third parties, Laredo has unparalleled infrastructure devoted to the handling of cross-border shipments. Laredo has uniquely well-developed capabilities for handling the customs, agricultural, immigration, narcotics and (increasingly in the post 9/11 world) security-related inspections required at an international

⁶³ In 1995, UP handled { } loads via Laredo; SP handled { } via Laredo in conjunction with Tex Mex; and SP handled { } loads via Eagle Pass. *Gray V.S. at 12 n.13 & Exh. F.*

⁶⁴ *See Gray V.S. at 12 & Exh. F.*

border. Laredo also has an unmatched community of brokers, freight forwarders and other third parties who assist shippers with customs and other aspects of the border crossing process. Gray V.S. at 14-15; Barkley V.S. at 3.⁶⁵ In significant part, these advantages are associated with the large volume of rail and truck traffic that moves through Laredo. Laredo's volume is more than twice that at the next largest U.S./Mexico crossing point (El Paso). Eagle Pass is a distant eighth, with barely eight percent of Laredo's volume. Gray V.S. at 15 & Exh. D.

The railroads serving Laredo also have made extensive investments to make it a uniquely efficient point for interchanging large volumes of cross-border rail shipments. UP has spent tens of millions on extensive yard facilities, mainline capacity, railcar inspection facilities, and other infrastructure needed to make Laredo work as a high volume rail border crossing point. Tex Mex and TFM have also made significant investments. Gray V.S. at 15-16; Barkley V.S. at 3. No other gateway has the basic infrastructure in place to handle the volumes of traffic that move via Laredo, much less to do it efficiently. Gray V.S. at 15-16; Barkley V.S. at 12-13.

Second, the Laredo Gateway provides the only efficient connection with TFM's Mexican rail network, which KCS regards as Mexico's "crown jewel system."⁶⁶ KCS understands that TFM is the Mexican railroad {{

⁶⁵ Applicants and the Board recognize these advantages, as noted above (at notes 53 & 54)

⁶⁶ Transcript of KCS Presentation to Analysts, April 29, 2003, Tr. at 13 (Exhibit 11).

}} TFM serves many important points in Mexico exclusively – such as Toluca, San Luis Potosí and much of Monterrey – and it has more efficient routes between the U.S. border and many other important Mexican points – including Monterrey and the industrialized areas in and around Mexico City. Gray V.S. at 18.

Two of TFM's significant advantages stem from failures in the Mexican privatization process that created both TFM and Ferromex. Under the privatization plan, Ferromex was to have received extensive access to TFM-served industries in the Monterrey area in order to create two-railroad competition there. However, TFM has taken advantage of the vagaries of Mexico's legal and regulatory systems to block Ferromex's access to Monterrey. *See* Fuentes V.S. at 6-7; Gray V.S. at 18-19.

In addition, Ferromex's Concession included a grant of hundreds of miles of trackage rights over TFM's Laredo-Mexico City mainline – between Ramos Arizpe (a point near Saltillo) and Querétaro – in order to give Ferromex an efficient route between the U.S. border and central Mexico (especially the so-called “Valle de Mexico” region encompassing Mexico City).⁶⁸ Ferromex's own route from Eagle Pass to Mexico City is 57 percent (407 miles) longer than TFM's route from Laredo. Ferromex's trackage rights over TFM reduce this disadvantage to only 48 miles, but they do not provide Ferromex with a useful or cost-effective alternative. Gray V.S. at 17-18. TFM has successfully imposed strict limitations on the traffic Ferromex can handle using these rights, and the limited traffic TFM allows

⁶⁷ *See* {{ }} (Exhibit 4); *see also* note 54, above.

⁶⁸ These rights are shown on the map set forth in Exhibit A to the Gray Verified Statement.

Ferromex to carry incurs extraordinarily high trackage rights fees. Ferromex must pay TFM the equivalent of \$0.71 per car-mile to use these rights, which is more than twice what BNSF and Tex Mex pay to use their extensive trackage rights over UP in the United States. *See Gray V.S.* at 17 & Exh. H. UP estimates that Ferromex's variable costs via these trackage rights are approximately 75 percent higher than TFM's costs for movements between the border and Mexico City. A large portion of this gap is accounted for by the unreasonably high fees. *Gray V.S.* at 18.⁶⁹

Finally, as Mr. Gray explains, shippers also benefit from the uniquely efficient and well-developed rail transportation service offerings via Laredo. TFM has cooperated extensively with both UP and Tex Mex (and its interchange partners KCS and BNSF) to develop highly efficient operating practices (such as pre-blocking), joint service offerings, and customs pre-clearance processes. *See id.* at 19-20.

B. Unconditioned KCS Control of Tex Mex and TFM Threatens to Undermine Competition Via the Laredo Gateway

In the *UP/SP* case, the Board recognized the importance of preserving effective two-railroad competition for international traffic moving via the Laredo Gateway. Concerned that the second railroad serving Laredo from the north – Tex Mex – would be threatened by diversion of SP-Tex Mex traffic to UP single-line routes, the Board granted

⁶⁹ KCS is well aware of the crippling competitive disadvantages these fees impose on Ferromex. In discussions with Ferromex and Mexican regulatory agencies in connection with the TFM acquisition, KCS has steadfastly refused to consider any material reduction in the level of those fees. *See Fuentes V.S.* at 9. KCS has insisted that any method for establishing fees take into account the \$1.4 billion price paid by KCS and Grupo TMM to acquire the TFM Concession in 1996, which underlay the calculation on which the current fee level was based. *Id.* KCS defends this position in a white paper provided to shippers and others in Mexico, *see Gray V.S.*, Exh. K, but the fact remains that Ferromex's viability as a competitive alternative is severely hampered by the high fees.

Tex Mex hundreds of miles of trackage rights over UP to forge a direct connection with KCS at Beaumont, Texas. The Board understood not only that Laredo was a vitally important gateway for growing NAFTA trade, but also that competition between U.S. railroads north of the border must be protected.

KCS's proposal to acquire control of Tex Mex and TFM calls for the Board to protect that competition once again.

1. Shippers Benefit from Competition Between UP and KCS/Tex Mex Routes for Traffic Moving Via Laredo

Today, as in 1996, Laredo is served by a single Mexican railroad. Before 1996 that railroad was Mexico's government-owned railroad system, the Ferrocarriles Nacionales de Mexico ("FNM"). Since 1996 that railroad has been TFM, which is controlled by Grupo TMM. TFM (like FNM before it) has interacted with its U.S. connections in an equitable and even-handed manner. TFM has sought to attract traffic to its system in Mexico without regard to which U.S. carrier handles the traffic north of the border. TFM has cooperated extensively with both UP and Tex Mex to develop highly efficient cross-border transportation options. Gray V.S. at 19-20. And, consistent with the requirements of Mexican railroad law and TFM's Concession, TFM has charged the same rate factors for its portion of the movement, regardless of which carrier it is working with. *Id.*; *see also* Fuentes V.S. at 4-5.

TFM's equitable behavior has created an environment in which competition between TFM's connections north of the border provides significant benefits for cross-border rail shippers. In *UP/SP*, Tex Mex described this competitive dynamic to the Board: "Because FNM [TFM's predecessor] sets its rates for the Mexican portion of international traffic without regard to the rates for the U.S. portion, the vigorous competition that now

and TFM, are second to none in servicing markets in Mexico.”⁷³ UP and KCS/Tex Mex are frequent rivals in bidding for shippers’ traffic, as Mr. Gray explains.

In addition, Tex Mex competes for traffic to and from points throughout the West (including western Canada) in conjunction with BNSF. Although KCS’s plans for Tex Mex appear to be creating frictions in the Tex Mex-BNSF relationship, Tex Mex cooperates very closely with BNSF on substantial volumes of traffic moving via Laredo.⁷⁴

2. KCS Will Have Incentives and Opportunities to Use Its Control of Tex Mex and TFM to Deprive Shippers of the Price and Service Benefits of UP-TFM Routings

Until now, TFM has not skewed the competitive playing field to favor KCS/Tex Mex routes via Laredo. Instead, although KCS/Tex Mex have cooperated closely with TFM to develop efficient cross-border transportation services, they have faced stiff and often successful competition from efficient UP-TFM services.

Armed with control of both Tex Mex and TFM, however, KCS will have the incentive and ability to manipulate competitive outcomes to favor routes in which its U.S. railroads (KCS and Tex Mex) participate. The incentives to do so will be extreme. KCS has strong incentives to increase its profits by capturing more traffic north of the border, in part to capture the margins on that traffic (Hausman V.S. at 10; Gray V.S. at 23-24) and in part to pay off the substantial debt it will be taking on when it acquires TFM. Substantial volumes of Laredo Gateway traffic will be available to KCS if it can impede UP-TFM

⁷³ KCS NEWS, “*Despacho Previo Process Clarified*,” March 5, 2002 (available on www.kcsi.com) (Exhibit 12).

⁷⁴ The fact that BNSF moves so much joint-line traffic across the Laredo gateway with Tex Mex – despite having its own single-line route to Eagle Pass – underscores the importance of the Laredo Gateway.

competition. As shown in Gray Exhibit J, only a small portion of the traffic now moving across the Laredo Gateway – { } percent – is not subject to handling by KCS and/or Tex Mex.

For this portion of UP TFM traffic, KCS may well have incentives to permit TFM to continue its cooperation with UP. However, the balance of the Laredo Gateway traffic – { } percent – is either handled by KCS/Tex Mex today or would be available to them were KCS to implement strategies aimed at degrading the transportation services available from UP via the Laredo Gateway. Gray V.S. at 25.

Applicants have told the Board that they do not anticipate any diversions of traffic resulting from KCS's control of TFM beyond the very modest decreases expected from the Tex Mex acquisition.⁷⁵ However, it is clear that KCS will be eager to seize every available opportunity to shift traffic from UP-TFM routes to KCS-Tex Mex-TFM (or BNSF-Tex Mex-TFM) routes. It would behave that way to lengthen hauls on the "NAFTA Rail" system and thereby earn greater profits.

And KCS has told Wall Street that it plans to do exactly that. Soon after KCS announced its plan to acquire control of Tex Mex and TFM, KCS's Chairman and CEO Michael Haverty told securities analysts that acquiring control of TFM will allow KCS to shift TFM's U.S.-Mexico traffic to Tex Mex/KCS routes, because the combined KCS/Tex Mex/TFM system would have "a lot of influence o[n] traffic that moves between Mexico

⁷⁵ Mr. Mutén forecasts that KCS control of Tex Mex alone – on the assumption that TFM would still be controlled by Grupo TMM – would lead to diversions to KCS/Tex Mex routes totaling 6,313 carloads annually. See Application, Mutén V.S. at 124. Applicants say they will seek this traffic because it will bring "additional revenues" to the combined system. Application, Haverty V.S. at 65.

and the United States,” and would thereby “draw more traffic to the combined system.”⁷⁶ He made clear that KCS will be “looking to lengthen the [existing TFM] haul” for “as much traffic . . . as we can.”⁷⁷ Similarly, KCS’s website describes the “strategic rationale” of the KCS/Tex Mex/TFM transaction as including the aim of “lengthen[ing] hauls through an ‘across-the-border’ view.”⁷⁸ KCS’s recent decision to tell the Board the opposite of this “strategic rationale” should be viewed with healthy skepticism.

Were this transaction to enable KCS/Tex Mex to attract additional traffic to their lines north of Laredo solely by improving services or lowering rates, those effects would be procompetitive rather than anticompetitive. Although UP might lose traffic, shippers would not be harmed and UP would not favor Board intervention.

In this case, however, KCS control of Tex Mex and TFM poses serious threats to the competitive process by undermining the transportation options available to shippers at the Laredo Gateway. And it will do so without promising any significant improvements in KCS/Tex Mex/TFM offerings. See pages 58-63, below. KCS emphasizes that it is acquiring *only* control, but control is all it needs to disrupt the competitive process by degrading UP-TFM competitive options and forcing traffic to KCS/Tex Mex lines. Competition for U.S.-Mexico cross-border traffic depends on efficient access to the Laredo

⁷⁶ KCS Presentation to Analysts, April 29, 2003, Tr. at 12, 20 (Exhibit 11).

⁷⁷ *Id.* at 10. Mr. Haverty declined to identify “just exactly what the revenue synergies are” – *i.e.*, the traffic diversions and increases in revenue on existing traffic that KCS expects – because KCS had based its initial financial analysis of the transaction on a static analysis. *Id.* at 20; *see also* Supplement at 9. Nevertheless, Mr. Haverty made quite clear that KCS in fact did anticipate traffic shifts stemming from its control of TFM.

⁷⁸ *See* KCS PowerPoint Presentation regarding NAFTA Rail transaction (available at www.kcsi.com/pdf/nafta_rail.pdf) at 4 (excerpts at Exhibit 6).

Bridge and effective cooperation from TFM, which is an indispensable link in all traffic moving across the border at Laredo. With control of both Tex Mex and TFM, KCS will have effective control of 100 percent of the Laredo Gateway traffic. KCS control of TFM will also allow NAFTA Rail to circumvent – in the United States – the non-discrimination requirements imposed by Mexican law and TFM’s Concession so as to extract additional profits from those cross-border shippers that are most dependent on rail. These strategies will not merely shift traffic away from UP-TFM routes, they will do so in *anticompetitive* ways by forcing shippers to pay more and accept poorer service.

KCS control threatens competition in three ways, as explained by economist Jerry Hausman and UP’s John Gray and Stephen Barkley.

a) KCS Can Use Its Control of TFM to Degrade UP-TFM Options

When KCS controls both Tex Mex and TFM, it will be in a position to make UP-TFM transportation options less attractive to shippers. It could use its control to cause TFM to discontinue cooperation with UP on operational or service matters, which would degrade the service available to customers from UP-TFM routes and increase shipper costs. KCS could, among many potential steps, cause TFM to cease pre-blocking traffic for UP, to withdraw from participation in efficient customs pre-clearance processes for UP traffic, to delay placement of empty equipment for UP shipments, or to increase transit times on shipments destined for or received from UP. Alternatively, KCS could cause TFM to stop working with UP to *improve* UP-TFM service offerings. Gray V.S. at 31-33. Any of these actions would not merely harm UP, but would deprive shippers of valuable competitive transportation options and thereby disrupt the competitive process. Hausman V.S. at 9-11; Gray V.S. at 33.

An even more serious threat to competition is the prospect that KCS would use its control of TFM to increase TFM rate factors in order to disable competition from UP-TFM offerings.⁷⁹ TFM's rate factors are perhaps the single most important aspect of TFM cooperation for U.S.-Mexico traffic. UP could have routes north of the border that were clearly the most efficient, UP services north of the border could be preferred hands-down over those offered by KCS-Tex Mex and BNSF-Tex Mex, and UP could have unrestricted use of the Laredo Bridge to cross its trains. But if TFM's rate factors were too high, shippers would lose the benefit of UP competition. Gray V.S. at 26. For the past six years, TFM has fostered effective competition among U.S. carriers by quoting comparable rates to both of its U.S. connections. TFM has done this in part because its parent, Grupo TMM, has no economic interest in favoring KCS routes over UP routes, and in part because of Mexican legal requirements. *Id.*; Fuentes V.S. at 4-5.

When it acquires control of TFM, however, KCS will have the power to manipulate TFM's rate factors to make UP-TFM services more expensive for shippers, causing them to pay more, and in some cases forcing them to switch to inferior KCS/Tex Mex/TFM offerings. KCS could accomplish this objective without refusing to quote TFM rate factors to UP, and even without discriminating between UP and KCS/Tex Mex in the rate factors it does quote. All that KCS needs to do is cause TFM to raise its rates in relation to KCS rates north of the border which Mexican non-discrimination rules would allow. Gray V.S. at 27; Fuentes V.S. at 4.

⁷⁹ This especially significant if the Board holds Applicants to their commitment to work with UP to develop methodologies for measuring and enforcing service standards for UP-TFM traffic via the Laredo Gateway.

A simple numerical example (spelled out in Table 1 below) helps illustrate how such a strategy might work. Assume that before KCS gains control of TFM, TFM has provided both UP and KCS/Tex Mex a rate factor of \$100 for traffic to an eastern gateway (these numbers are purely illustrative), and that UP and KCS compete to handle the traffic north of Laredo. Assume that UP has the more efficient route and also charges a rate factor of \$100. KCS's rate factor is \$105. In today's fair competitive process, the shipper will chose the UP-TFM option and pay \$200. This outcome is shown in the left-hand portion of the bottom row of Table 1.

After KCS acquires control of Tex Mex and TFM, it can change this result to the disadvantage of shippers. All it needs to do is instruct TFM to raise its rate factor by at least six dollars, as shown in Example 1 in the table. If it did that, the combination UP-TFM rate would now be \$206, while KCS/TFM could charge \$205 and win the business. KCS would collect this total amount by lowering its own factor to \$99, a step it could take because it will get those dollars back through its ownership of TFM. The combined KCS/Tex Mex/TFM would make more money (and more profit, because KCS's previous \$105 factor included some return), but the shipper would pay more and lose its preferred route north of the border. *See Gray V.S. at 27; Hausman V.S. at 9-11.*

TABLE 1			
	BEFORE KCS/TFM CONTROL	AFTER KCS/TFM CONTROL	
		Example 1	Example 2
UP Factor	\$100	\$100	\$100
KCS Factor	\$105	\$99	\$95
TFM Factor	\$100	\$106	\$120
UP-TFM Rate	\$200	\$206	\$220
KCS-TFM Rate	\$205	\$205	\$215
Outcome	UP wins; shipper pays \$200	KCS wins; shipper pays \$205	KCS wins; shipper pays \$215

As Mr. Gray explains, KCS could use a similar strategy to increase its profits to shippers' detriment where service rather than rates had led shippers to prefer UP-TFM routings in the pre-transaction period. Alter the above example to assume that UP and KCS/Tex Mex had offered to handle traffic from Laredo to an eastern gateway at comparable \$100 rate levels, taking advantage of TFM's non-discriminatory (\$100) rate factor, but that the shipper had chosen the UP route because it offered consistently faster transit times. After the transaction, TFM could increase its rate factor by \$5 to both UP and KCS/Tex Mex, with KCS/Tex Mex lowering its factor by \$5 to offset TFM's increase. To avoid a rate increase (from \$200 to \$205) the shipper would be forced to use the less attractive KCS/Tex Mex route north of Laredo. Alternatively, the shipper may conclude that it has a sufficiently strong preference for UP service that it is willing to pay \$5 more to use it (a fact TFM likely would not have known until KCS/TFM attempted this strategy). Either way, KCS/Tex Mex/TFM would earn additional profits and the shipper would lose. Gray V.S. at 28.

KCS would have a great deal of latitude to manipulate TFM's rates even more than shown in the example, thereby making it even more difficult for UP-TFM service offerings to remain price-competitive. There are no effective Mexican regulatory limits on the level of TFM's rates for transportation within Mexico, as Mr. Fuentes explains. *Fuentes V.S.* at 3-4, 6. KCS could cause TFM to increase its rate factors as much as necessary to assure that UP was effectively disabled from competing, with KCS reducing its portion of the through rate enough to win the business and increase profits, but not so much that the traffic would dry up. The right-hand portion of Table 1 (Example 2) demonstrates the effect of a 20 percent increase in TFM's factor, which would allow KCS/TFM to win the business while simultaneously increasing the customer's rates significantly. *See Gray V.S.* at 28-29.

As Professor Hausman and Mr. Gray explain, KCS's implementation of such a strategy would hurt shippers and competition, not just UP. For a number of reasons, TFM does not extract from each piece of traffic moving via Laredo the last dollar of revenue that might conceivably be available by virtue of TFM's market power. Most rates are quoted to customers on a "Rule 11" basis, which involves each railroad charging the customer its own, separate rate to the U.S./Mexico border, typically without any agreement by the carriers about what the overall origin-to-destination price should be. This limits the degree to which TFM can differentiate among customers based on their specific circumstances and demand factors. For many shippers, moreover, TFM quotes one rate to the Mexican receiver (or shipper), while the U.S. carrier quotes its rate to a separate entity (either the shipper or receiver) in the United States. TFM's practice of quoting non-discriminatory rates also limits the extent to which it can effectively charge the highest rate that each piece of traffic can bear. *See Gray V.S.* at 29; *see also Hausman V.S.* at 11-12.

Meanwhile, north of the border, for traffic that is competitive between UP and KCS/Tex Mex (and its connections), competition between the U.S. railroads keeps rates competitive today – preventing either U.S. carrier from picking up the dollars TFM leaves on the table. Because of this competition, UP would not have significant room to reduce its own revenue requirement in order to offset any higher TFM factors imposed by KCS. As a result, when such strategies extinguish competition from UP north of the border, they will remove constraints on KCS's rates, causing rate increases and reductions in the level of rail service for shippers. Hausman V.S. at 10-11; Gray V.S. at 30.

KCS likely would conclude that this strategy would not work to the same extent for all shippers. For those shippers with relatively better access to other transportation options (such as truck or barge) or more elastic demand for other reasons, KCS could offer lower rates by reducing its factor north of the border by somewhat more. For traffic that UP could efficiently route via Eagle Pass in conjunction with Ferromex, KCS might choose to maintain the status quo so that TFM could keep its existing Mexican portion of the revenues. But for significant amounts of existing Laredo traffic (both UP-TFM and Tex Mex-TFM), rates will increase and service will suffer. Gray V.S. at 30.

This strategy would be even easier for KCS/TFM to implement if Mexican law did not require TFM to offer its U.S. connections comparable rate factors for comparable traffic. If TFM could discriminate overtly against UP, KCS could simply cause TFM to raise its revenue requirements to UP but not to Tex Mex and/or KCS, and the result would be the same: UP's costs effectively would go up, KCS could win the business despite charging higher rates, and shippers would lose. *Id.*

b) KCS Control Will Create New Opportunities for KCS/TFM to Exploit TFM's Market Power By Selectively Raising Rates on Cross-Border Traffic

In addition to disabling a substantial amount of UP competition north of the border, KCS control of TFM would enable NAFTA Rail to increase rates where that TFM alone could not. As Applicants point out, Mexican law and TFM's Concession impose limits on the degree to which TFM can discriminate with respect to rates among similarly situated shippers or TFM's U.S. connections.⁸⁰ As Professor Hausman explains, to the extent these non-discrimination rules constrain TFM's ability to differentiate freely among shipments based on their transportation alternatives or other factors affecting their demand elasticity, TFM cannot exploit the full measure of its market power within Mexico. Hausman V.S. at 12; *see also* Gray V.S. at 29. In effect, TFM's rate factors are constrained by the competitive options of the *most elastic* shipments, causing it to charge lower rates than it otherwise would if it had perfect freedom and perfect knowledge. *Id.* Consumers benefit from this situation. The lower TFM rates get passed along to cross-border shippers, because the U.S. carriers' rates are constrained by rail-to-rail competition north of the border.

KCS control of TFM will change this environment by giving the commonly-controlled company will have the ability to price discriminate freely. KCS could simply cause TFM to raise its rate factors to levels that extract the full measure of TFM's market power for its least-elastic shipments. These shippers would suffer rate increases, even if they continued to use UP-TFM routings. Meanwhile, by manipulating the KCS/Tex Mex

⁸⁰ Supplement at 30; *see also* Fuentes V.S. at 4-5.

rate factor north of the border, KCS could hold rates constant for traffic that could least sustain a rate increase. An illustrative example is given in Table 2 below. *See Hausman V.S. at 11-15.*

TABLE 2				
	Before KCS/TFM Control		After KCS/TFM Control	
	Elastic Traffic	Inelastic Traffic	Elastic Traffic	Inelastic Traffic
TFM Factor for Elastic Traffic	\$100	\$100	\$120	\$120
KCS/Tex Mex Factor	\$100	\$100	\$80	\$100
UP Factor	\$100	\$100	\$100	\$100
Outcome	Shipper pays \$200 (Traffic moves UP-TFM or KCS-TM-TFM)	Shipper pays \$200 (Traffic moves UP-TFM or KCS-TM-TFM)	Shipper pays \$200 (Traffic moves KCS-TM-TFM)	Shipper pays \$220 (Traffic moves UP-TFM or KCS-TM-TFM)

The overall effect would be rate increases for significant numbers of shippers.

c) KCS Control Will Create New Incentives and Opportunities for Tex Mex and TFM to Manipulate Operations at the Laredo Bridge

A further immediate threat to competition involves operation of the Laredo Bridge. This crucial connection between the United States and Mexico is controlled by Tex Mex and TFM, which own the track structure on the northern and southern halves of the Bridge, respectively. *Barkley V.S. at 2.* TFM interchanges with both UP and Tex Mex at Laredo, with UP-TFM movements constituting approximately 75-80 percent of the freight moving across the gateway. *Id. at 3.* Operations over the Bridge are governed by a 1951 agreement between UP and Tex Mex, but that agreement leaves open the potential for Tex Mex to manipulate operations to favor its own trains even while claiming that UP is

receiving “equal” treatment. As long as Tex Mex was controlled by an independent TFM, Tex Mex’s incentives to restrict UP’s use of the Bridge have been held in check. Once Tex Mex is under KCS control, Tex Mex and TFM will have greater incentives to prefer Tex Mex-TFM traffic over UP-TFM traffic. Preferential treatment would reduce service levels for UP customers and inefficiently divert traffic to Tex Mex-TFM routes.

TFM’s increased incentive to give preferential treatment to Tex Mex at Laredo Bridge presents a serious concern. As explained by Stephen R. Barkley, UP’s Regional Vice President - Southern Region, it is highly important for UP and its customers to have an operation at Laredo that is efficient and that provides even-handed treatment for UP trains. Movements over the single-track Laredo Bridge involve a delicate operational balance. Barkley V.S. at 4. Like all international border crossings, crossings at Laredo take extra time due to government paperwork and inspections. *Id.* With two railroads north of the border connecting with one railroad south of the border, interchanges must be carefully coordinated. It is essential to stage trains carefully, so that they are ready to move onto the Bridge quickly as soon as the previous interchange is complete. *Id.* at 5. To maximize Bridge capacity, the railroads have set aside alternating six-hour “windows” for northbound and southbound traffic. *Id.* at 6.

When there are more trains waiting than can be moved across the Bridge during a window, the priority in which trains are given access to the bridge becomes very important. Mr. Barkley explains that, in recent years, the Border Superintendent (a TFM employee since 2001) has been generally even-handed in his treatment of UP and Tex Mex trains, providing priority to each railroad in the approximate proportion of its traffic over Laredo. Barkley V.S. at 7, 8-9. Thus, TFM, which today has an interest in maximizing its

traffic volumes without regard to the identity of its partner north of the border, has overridden Tex Mex's impulses to favor Tex Mex-TFM traffic. However, when the economic interests of TFM and Tex Mex become more closely aligned due to common control, the Border Superintendent is more likely to find subtle (or not so subtle) ways to give preference to Tex Mex trains. In particular, the Border Superintendent may accept an argument that Tex Mex personnel have pressed in the past – that each railroad should receive 50 percent of the available Bridge slots, even though Tex Mex carries only 20 to 25 percent of the freight that moves through Laredo. *See id.* at 9, 10-11. Such a 50-50 allocation would leave UP trains at the end of the queue, unable to cross when there were more trains waiting than could move across the Bridge during a window.

Applicants deny that the Laredo Bridge operations will change under common control. They point out that Bridge operations are governed by written agreements and that UP could enforce Tex Mex's contractual obligations.⁸¹ However, the written agreements they cite speak in very general and perhaps conflicting terms. The 1951 agreement between Tex Mex and a UP predecessor provides that "Joint Switching Service" shall be "performed impartially" and that "no preference shall be given to movement of cars of one of the parties."⁸² The agreement does not specify what these words mean, how the obligations apply in the context of today's operations (which differ from those described in the 1951 agreement in significant ways), or just how impartial treatment is to be accomplished.

⁸¹ *See, e.g.,* Reply to UP's Petition For Declaratory Order (KCS-11/TM-11) (June 23, 2003) at 7-10; Supplement at 27.

⁸² 1951 Agreement, § 4(III) (Barkley V.S., Exh. B).

The 1951 Agreement is not enough to protect against the changed incentives created by common control. There must be more specific guidance addressing how the “no preference” requirement is to be implemented. Otherwise, Tex Mex and TFM could argue that a one-for-one priority system is acceptable because it gives “no preference” to either carrier, even though UP’s shippers, which today account for the great majority of traffic at Laredo, would be shortchanged under such an allocation. *See* Barkley V.S. at 13-14.

In view of the competitive threat presented by Tex Mex’s increased incentives to give preference to Tex Mex trains at Laredo, it is appropriate for the Board to impose conditions that will constrain the ability of the railroads to act in this manner. . . . And, in light of Applicants’ assertion that the NAFTA Rail carriers would not and could not change operations at Laredo Bridge following acquisition of common control,⁸³ they should have no serious objection to imposition of conditions that will provide greater assurances on this point. As discussed in Section IV, below, UP urges the Board to impose a narrow condition requiring Applicants to negotiate a new protocol governing Bridge operations that will effectively avoid any potential competitive abuse and ensure that the Bridge will continue to be operated in an efficient and fair way.

3. The Lack of Procompetitive Benefits Elevates the Threat to Competition

In many rail merger cases, the Board must weigh the potential anti-competitive harms against the pro-competitive efficiencies that might flow from the transaction. The applicants typically will anticipate significant traffic and revenue gains

⁸³ *See* KCS-11/TM-11 at 7-10.

stemming from their transaction, and the Board must assess the extent to which those private gains are the result of *pro-competitive* improvements in rates and service, rather than the product of anticompetitive actions made possible by the transaction. In this case, however, there is no need to engage in such an analysis. Combining KCS, Tex Mex, and TFM under common control will not achieve any significant efficiencies that could not be accomplished without KCS control.⁸⁴ The *only* effect of this transaction will be to transfer control of Tex Mex and TFM from Grupo TMM to KCS. *See* KCS-16/TM-16. As the Applicants have made abundantly clear, KCS, Tex Mex, and TFM have already aligned their operations closely, and they are planning to keep the three carriers intact and separate.⁸⁵ But control is all that KCS needs to accomplish the anticompetitive harms described above. Control will enhance KCS's profits, but it will do so at the cost of higher rates and poorer service.

Common control will not strengthen KCS/Tex Mex/TFM as a competitive alternative to UP-TFM: the KCS/Tex Mex/TFM alliance known today as the "NAFTA Railway" already provides that alternative, and nothing about KCS control will make it stronger, except financially by forcing anticompetitive shifts in U.S.-Mexico traffic flows. Importantly, however, if UP has overlooked important benefits stemming from common

⁸⁴ It is well established that benefits are "merger-related" only if they would not – or could not – be achieved without the transaction. The Board's new major merger rules codified the principle that "when evaluating the public interest, the Board will consider whether the benefits claimed by Applicants could be realized by means other than the proposed consolidation." *See Major Rail Consolidation Procedures* at 16, 21 (discussing 49 C.F.R. § 1180.1(c)).

⁸⁵ The Application does claim that some efficiencies will be created through elimination of duplicative Tex Mex administrative functions. Application, Riney V.S. at 62. However, given Tex Mex's size compared to KCS and TFM, those savings will be relatively small in the context of the combined NAFTA Rail. No such efficiencies are claimed as to TFM.

control – such that shippers might in the future choose to route via KCS/Tex Mex routes because of service or rate improvements that this transaction makes possible – the conditions UP is asking the Board to impose to prevent anticompetitive harms would not stand in the way of those benefits.

a) Existing KCS Coordination with TFM and Tex Mex

Since at least 1999, KCS has sought to integrate its operations with both Tex Mex and TFM – as part of their extant “NAFTA Railway” alliance – to provide the efficiencies associated with single-line service. These railroads have already put in place numerous coordinations that have nothing to do with KCS control, including:

- pre-blocking of trains moving to and from Mexico over KCS, Tex Mex, and TFM;⁸⁶
- consolidation of KCS and Tex Mex dispatching, crew calling, and timekeeping;⁸⁷
- transfer of Tex Mex’s operations center to KCS’s operations center;⁸⁸ and

⁸⁶ Last July, KCS reported on progress achieved by a joint KCS/Tex Mex/TFM team responsible for achieving improved coordination among these carriers: “[e]ach week, the team covers service performance related to KCS’ new pre-blocking plan for traffic going southbound into Mexico, despacho previo and clearances that will help expedite traffic.” KCS also reported that the partners were working on an initiative “to create a similar plan for operational efficiency going northbound, to include the possibility of TFM pre-blocking traffic to save handling and transit time on traffic moving from Mexico to US Markets.” KCS NEWS, “*NAFTA Railway Partners Reflect and Pursue New Opportunities*,” July 9, 2002 (available on www.kcsi.com) (Exhibit 12); *see also* Application, Riney V.S. at 136 (“KCSR, Tex Mex and TFM implemented a plan to pre-block trains moving to and from Mexico”).

⁸⁷ As KCS has reported, the NAFTA Alliance partners have already put into effect “the consolidation of KCS and Tex Mex dispatching, crew calling and timekeeping to KCS’s System Transportation Center in Shreveport.” KCS NEWS, “*Nafta Railway Partners Reflect and Pursue New Opportunities*,” July 9, 2002 (Exhibit 12).

- participation by KCS in Tex Mex capital improvement projects, including applications for federal funding of Tex Mex investments.⁸⁹

KCS has repeatedly touted these and other coordinations with Tex Mex and TFM as having allowed these railroads to provide “seamless, one stop service” for U.S.-Mexico traffic.⁹⁰ According to KCS, together with its partners Tex Mex and TFM it is “second to none in servicing markets in Mexico.”⁹¹

Applicants emphasize that the fact they are already so closely coordinated will facilitate the transition to common control, rather than that control will bring major benefits.⁹² The one operational improvement that Applicants claim is in fact already in progress and is not dependent on approval of the transaction. Applicants assert that KCS control of Tex Mex and TFM will enhance rail safety because both Tex Mex and TFM will implement KCS’s Management Control System (“MCS”).⁹³ However, long before KCS announced its acquisition of Tex Mex and TFM, KCS announced that it was installing MCS

(... footnote continued from previous page)

⁸⁸ See Application, Haverty V.S. at 62 (“Tex Mex’s operations center has been transferred to KCSR’s operation center and KCSR pre-blocks trains for Tex Mex. KCSR also handles Tex Mex’s dispatching.”).

⁸⁹ See Application at 15 (KCS *already* assisting Tex Mex in applying for funding); *id.*, Riney V.S. at 135-39; KCS NEWS, “*NAFTA Railway Partners Reflect and Pursue New Opportunities*,” July 9, 2002 (available on www.kcsi.com); KCS NEWS, “*State of the Railroad: From the Desk of Michael R. Haverty, Chairman, President and CEO*,” Dec. 17, 2002 (available on www.kcsi.com) (Exhibit 12) (explaining that that KCS was seeking funding for several projects, including Tex Mex projects).

⁹⁰ KCS NEWS, “*NAFTA Railway Partners Reflect and Pursue New Opportunities*,” July 9, 2002 (available on www.kcsi.com) (Exhibit 12). Applicants’ Environmental Appendix (KCS-13/TM-13) similarly emphasizes that KCSR and Tex Mex already “have achieved near seamless operation.” See *id.*, Safety Implementation Plan at 3.

⁹¹ KCS News, “*Despacho Previo Process Clarified*,” March 5, 2002 (Exhibit 12).

⁹² *E.g.*, Application, Riney V.S. at 135.

⁹³ Application, Riney V.S. at 140; Supplement at 32.

on Tex Mex.⁹⁴ Likewise, prior to KCS's proposal to acquire TFM, KCS and TFM personnel were meeting to "formulate a business case for implementing the [MCS system] on TFM." That meeting was one of "many steps toward a projected implementation of MCS on TFM in the first quarter of 2004" and, according to KCS, marked "another important step toward creating a more seamless NAFTA Railway operation."⁹⁵

b) No Further Coordinations Are Planned

Aside from implementing MCS on TFM, the Applicants do not plan any further operational improvements following either the Tex Mex or TFM acquisitions. The Application explicitly disclaims operational changes on either railroad:

- "The TFM transaction will not alter the basic structure or operations of TFM." (Supplement at 25).
- "Even though KCSR will become affiliated with TFM, the two carriers are not merging nor is TFM acquiring or taking control of KCSR. TFM will continue to be operated from Mexico City, with separate officers and boards of directors from KCS and KCSR." (Supplement at 7).
- The transaction will result in "no significant changes . . . to operations" because KCS and Tex Mex already "have achieved near seamless operation." (Environmental Appendix, Safety Implementation Plan at 3).

⁹⁴ More than a year ago KCS reported that the NAFTA partners planned to implement MCS on both KCS and Tex Mex. KCS NEWS, "*NAFTA Railway Partners Reflect and Pursue New Opportunities*," July 9, 2002 (available on www.kcsi.com) ("another key topic was that of future projects like the implementation of MCS on KCS this summer and on Tex Mex later this year"). Mr. Haverty indicated in December 2002 – still long before KCS proposed to acquire control of Tex Mex – that KCS intended to implement MCS on Tex Mex in 2003. KCS NEWS, "*State of the Railroad: From the Desk of Michael R. Haverty, Chairman, President and CEO*," Dec. 17, 2002 (available on www.kcsi.com) (Exhibit 12). In fact, KCS and Tex Mex are proceeding with these plans without regard to Board approval of the Application. Applicants' Safety Implementation Plan reports that, "[i]n the 3d and 4th quarters of 2003, MCS will be implemented on Tex Mex." Environmental Appendix (KCS-13/TM-13), Safety Implementation Plan at 11.

⁹⁵ KCS NEWS, "*KCS, TFM Move Toward More Seamless Operation*," July 9, 2002 (available on www.kcsi.com) (Exhibit 12).

- “Operations of Tex Mex and KCS have become closely coordinated in a number of areas as the volume of traffic moving over Tex Mex’s trackage rights has increased. Because of this existing coordination, bringing [KCS] and [Tex Mex] under control of the same holding company should not result in any disruption of service because no fundamental changes in service patterns will occur.” (Application, Riney V.S. at 136).
- “KCSR and Tex Mex train and yard operations will not change significantly as a result of the transaction,” and “it is not anticipated that bringing the two companies under common control will have a significant effect on traffic levels or other basic operating indicators.” (Application, Hefley V.S. at 150.)⁹⁶

Absent significant efficiencies – of which there are none – KCS control of all aspects of Tex Mex and TFM actions, from marketing and pricing to the day-to-day operational matters upon which connecting railroads such as UP depend, will pose uniquely severe threats to competition. The Board can avoid that harm through simple conditions that embody promises Applicants have already made and preserve the ability of KCS/Tex Mex/TFM to become more efficient under common control if new opportunities present themselves.

4. Many Shippers Have Expressed Concerns About the Competitive Impacts of the Proposed Transaction

UP is not alone in expressing concerns about the adverse impacts that KCS’s control of Tex Mex and TFM would have if KCS’s commitments are not implemented in an effective and enforceable manner through Board conditions. UP is providing, at Exhibit 13, a compilation of more than 20 letters and statements from shippers who have called upon the Board to ensure that competition via the Laredo Gateway is protected.

⁹⁶ See also *id.* at 153 (transaction “will not perceptibly change day-to-day train or yard operation of the two companies”).

For example:

- AK Steel, which ships rolled steel from the Midwest to Mexico over the Laredo Gateway, writes:

“AK Steel is concerned that once the formation of the NAFTA Railway is completed, TFM will favor traffic that originates on its affiliated companies, i.e., KCS and TexMex, over interchange traffic received from UP or [BNSF]. If such discriminatory practices occur, there would be a detrimental impact on cycle times, which would greatly impact AK Steel’s ability to obtain reliable and efficient transportation service into Mexico.

“In addition, AK Steel is concerned that the formation of the NAFTA Railway could impact on the ability of competing carriers to provide service to Mexico on commercially reasonable terms. . . . The combination of KCS/TexMex/TFM . . . presents an incentive for TFM to favor KCS/TexMex to the detriment of other carriers, like UP and BNSF, that connect with TFM at the Laredo Bridge. . . . Such practices would greatly limit UP’s and BNSF’s ability to provide competitive priced service for AK Steel’s transportation needs to the Mexican gateway.”

- Badger Mining, which ships silica sand from Wisconsin mines to TFM-served foundries in Monterrey and Saltillo, writes:

“We are concerned that the proposed NAFTA Rail transaction might affect the rates and service that UP can offer for our shipments moving over the Laredo Gateway. Our Mexico traffic moves over the Chicago Gateway, so it is susceptible to routings involving KCS. If the NAFTA Rail transaction improves those routings, we would welcome the additional competitive options. However, Mexico is an important growth market for Badger Mining, and we want to ensure that the transaction does not interfere with our ability to use the existing, efficient UP-TFM service.

“. . . . It is our experience in the railroad business that there are many subtle ways to discriminate against competition, so clear, enforceable standards are important.”

Chicago Sweeteners, which ships manufactured food products to and from Mexico over the Laredo Gateway, explains that “[a]nything that would discriminate against Union Pacific

would be a direct discrimination against all that use is lines to ship to and from Mexico.”

- General Chemical, which is a member of an export cooperative that ships soda ash to Mexico over the Laredo Gateway, explains that “UP has coordinated service with the TFM set up via Laredo, TX, including several daily run-through trains with pre-blocking of railcars,” and that “UP has spent significant capital to improve border facilities and to automate customs activities to help the flow of international shipments between the U.S. and Mexico.” It asks the Board to impose conditions “to ensure continued competitive and efficient rail service via the Laredo gateway for customers using the current UP-TFM rail routing.”
- Hub Group, which wrote the Board in support of the Application, subsequently filed an additional letter to state that it “strongly supports conditions that will guarantee continued competitive and efficient UP/TFM rail service via the Laredo gateway.”
- International Paper, which shipped more than 186,000 tons of paper products over the Laredo Gateway, states that it has “a number of concerns about the possibility of potential discrimination against either UP or BNSF traffic at the International Bridge at Laredo and, through its affiliation with TFM, in Mexico.” It explains that the “cooperation of interlining railroads in establishing equitable and efficient car supply and car hire agreements, compatible train schedules and fair divisions of interline freight revenues.”⁹⁷
- Reagent Chemical & Research, which exports hydrochloric acid to Mexico via the Laredo Gateway, states that it has “concerns that the ownership of the International Bridge at Laredo be [sic] under the sole control of the NAFTA Rail carries, and that those controlling the bridge continue to offer the UP complete and uninhibited access to the bridge crossing.”
- Unimin, which ships ball clay from Texas and Tennessee plants to the Monterrey area over the Laredo Gateway writes:

“Until now, TFM had no reason to favor ball clay shipments that originate in Tennessee over shipments that originate in Texas, or vice versa. Following the proposed transaction, TFM will have reason to favor KCS, because they will be under common ownership. If the combined entity raises the price of transporting Unimin’s Troup, Texas ball clay from Laredo to Monterrey or uses

⁹⁷ International Paper’s letter was filed directly with the Board and is not included at Exhibit 13.

its control over the Laredo Bridge to make UP's service slower or less predictable, Mexican tile and sanitaryware producers may shift to the Tennessee producers. This will benefit KCS because KCS can carry Gleason, Tennessee ball clay from New Orleans, Louisiana (where CSX connects to KCS) to Laredo. ...

“We respectfully request that the Board impose detailed conditions of neutrality and non-discrimination in order to preserve competition among rail carriers and to enable Unimin to compete fairly for sales to Mexican customers. The Laredo Bridge cannot be duplicated by competitors, and the other rail crossings from Texas into Mexico are far inferior to it. This Board should not allow control of Laredo Bridge to confer a competitive advantage on the combined KCS-TFM.”

- Weyerhaeuser Company, which has packaging plants and distribution facilities for its forest products across the United States, Canada, and Mexico, asks the Board to address several concerns, including concerns that Applicants “must insure that all existing gateways will remain open” and that they “must provide the Board with assurances and process, which can be monitored to insure the impartiality of [their] Mexican partner in dealings with other railroads.”

In all, a broad cross-section of more than twenty shippers of products ranging from chemicals, to grain, to forest products, to intermodal, to steel – and including shippers that also filed comments expressing support for the transaction – have asked the Board to impose conditions to make concrete and enforceable KCS’s commitments to preserve competition for traffic moving over the Laredo Gateway. Even DuPont, which did not ask the Board to impose conditions on the transaction, nonetheless considered “significant” the “KCS commitment to abide by all existing agreements governing operations of over the Laredo Bridge and to keep the Laredo gateway open on commercially reasonable terms.”⁹⁸ Other shippers have no doubt refrained from participating actively in this case based on their

⁹⁸ See Prepared Remarks by E.I. DuPont de Nemours, STB Finance Docket No. 34342, filed July 29, 2002 at 3.

expectation that the Board will act – as it has done in every other recent case – to hold Applicants to their well-publicized commitments.⁹⁹

5. Professor Grimm's Competitive Analysis Ignores the Anticompetitive Effects of KCS Control

Applicants' analysis of the effects of their proposed transaction fails to consider the potential that an end-to-end (or "vertical") transaction can have anticompetitive effects. Applicants' competition witness – Professor Curtis Grimm – explicitly limited his analyses to potential "horizontal" competitive effects for 2-to-1 or 3-to-2 shippers,¹⁰⁰ and thus ignored the potential harms from this vertical transaction. *See Hausman V.S.* at 20-21. Professor Grimm applied the federal antitrust agencies' 1992 "Horizontal Merger Guidelines," which on their face apply only to "horizontal merger[s]."¹⁰¹ As explained in the joint agency statement announcing those Guidelines, they "do not include a discussion of horizontal effects from non-horizontal mergers (*e.g.*, elimination of specific potential entrants and competitive problems from vertical mergers)."¹⁰²

Based on Professor Grimm's unduly narrow analysis – and the observation that TFM is an indispensable link in every cross-border movement via Laredo and is thus a part of every "independent railroad routing"¹⁰³ – Applicants assert that their transaction cannot possibly have anticompetitive effects. Instead, they characterize the effects of which

⁹⁹ *See* page 89, *infra*.

¹⁰⁰ Application, Grimm V.S. at 77-78; Supplement, Grimm V.S. at 2-3.

¹⁰¹ Application, Grimm V.S. at 78; Horizontal Merger Guidelines § 0.2 (available at <http://www.ftc.gov/bc/docs/horizmer.htm>).

¹⁰² *See* <http://www.ftc.gov/bc/docs/horizmer.htm> (excerpts at Exhibit 14).

¹⁰³ KCS-14/TM-14 at 13-14 (KCS/Tex Mex responses to Interrogatories 3, 5) (excerpts at Exhibit 15).

UP and others complain as impacts solely on competing carriers rather than impacts on competition.

As Professor Hausman explains, however, Applicants are wrong. It is well recognized that vertical transactions *can* have significant anticompetitive effects. Although many vertical mergers are often not anticompetitive, this transaction poses unique competitive dangers. Applicants' analytical approach sweeps under the rug the unique dynamic of competition for U.S.-Mexico traffic moving via the Laredo Gateway. TFM's incentives (commercial and regulatory) to behave equitably vis-à-vis UP and Tex Mex at the Laredo Gateway have created an environment in which competition north of the border has flourished and in which TFM has not fully exploited its market power with respect to U.S.-Mexico cross-border movements. Although this transaction is "end-to-end," KCS control of Tex Mex and TFM will nevertheless adversely affect the existing two-carrier competition for traffic moving via Laredo. Gray V.S. at 20-33; Hausman V.S. at 9-18.

Professor Hausman explains that vertical mergers can produce anticompetitive effects when the merged entity can decrease the service quality or increase the costs of its rivals. Hausman V.S. at 21. By discriminating against a competitor and causing its service quality to be lower, a firm can increase its own demand and often charge higher prices. *Id.* As Professor Hausman explains, the risk is more than theoretical in the circumstances of this case, because for many shippers, neither other U.S.-Mexican gateways nor intermodal competition significantly constrains a "hypothetical monopolist" from increasing price. *Id.* at 6-7.

This is precisely the risk that Mr. Gray describes. Gray V.S. at 31-33. For example, if KCS/Tex Mex/TFM increase UP's costs by interfering with operations at the

Laredo Bridge or by declining to participate in blocking or run-through trains or through other tactics, UP will be forced to raise its rates (or shippers suffering service reductions will feel as if their costs have increased), thereby allowing KCS/Tex Mex/TFM to capture the traffic of those shippers despite offering higher prices or lower service levels. Hausman V.S. at 10. This result is not merely a shift in traffic from UP to KCS, but a genuine loss of competition and harm to shippers. *Id.* at 11.

Professor Hausman also describes a second type of anticompetitive effect that might flow from the end-to-end transaction in this case. He explains that vertical mergers can lead to evasion of regulation and allow the combined firm to better price discriminate. *Id.* at 22.¹⁰⁴ As Professor Hausman explains, to the extent that Mexican law requires TFM to charge the same price for similar movements to and from Laredo for similar commodities, TFM is constrained in the prices it can charge. *Id.* at 12. If TFM attempted to increase the price it charges between Laredo and a given point in Mexico, the increased revenues from less-price-elastic customers would be offset by revenue losses from relatively more price-elastic customers who switch to alternative transportation modes or gateways. *Id.* Thus, TFM's prices to less-elastic customers are lower than they would be if TFM could price discriminate freely. *Id.* Moreover, competition among U.S. railroads north of Laredo prevents TFM's connecting carriers from capturing the extra revenue. *Id.* The proposed transaction will change this dynamic by allowing KCS/Tex Mex/TFM to increase prices to

¹⁰⁴ "Evasion" does not refer to any act that would violate Mexican law, but to conduct that TFM could not accomplish today but which a combined KCS/TFM could undertake. Hausman V.S. at 13 n.16.

less-elastic customers while maintaining prices to more-elastic customers at existing levels in order to retain TFM's existing traffic. *Id.* at 13.

Once again, the risk of anticompetitive harm is present in the circumstances of this case. Mr. Fuentes concludes that Mexican regulation would likely not prevent a commonly-controlled KCS/Tex Mex/TFM from engaging in such tactics as long as TFM continued to offer "non-discriminatory" rates for the Mexican portion of the movement. Fuentes V.S. at 3. Mr. Hausman examined the amount of traffic on which KCS/Tex Mex/TFM could potentially employ the rebate strategy and concluded that it is considerably more than needed to result in significant price increases to shippers. Hausman V.S. at 16.

C. Applicants' Arguments Do Not Overcome the Likely Anticompetitive Effects

In its filings in this proceeding and in other public comments about the proposed KCS/Tex Mex/TFM transaction, Applicants have argued that the Board and other interested parties should not be concerned about potential adverse competitive effects of KCS acquiring control of Tex Mex and TFM for four reasons. First, Applicants assert that there is "pervasive truck and barge competition for the U.S./Mexico trade." Supplement at 25; *see also id.* at 13-19. Second, they point out that approximately three-fourths of TFM's interchange traffic at Laredo is with UP, which they assert gives UP substantial "bargaining leverage over a combined KCSR/Tex Mex/TFM System." Supplement at 25. Applicants contend that TFM would have no choice but to continue working with UP, lest UP otherwise shift its traffic "away from the Laredo gateway and away from TFM."¹⁰⁵ Third, Applicants

¹⁰⁵ Supplement at 24.

argue that UP has a “chokehold” over KCS/Tex Mex’s ability to compete that would prevent KCS/Tex Mex from gaining traffic from UP-TFM routes. Fourth, Applicants emphasize that the commitments they have made in this proceeding will successfully avoid anticompetitive harm.

None of these arguments has merit. We address the first three here and turn to the fourth in Section IV.

1. Other Transportation Alternatives Will Not Prevent Anticompetitive Effects

Applicants’ suggestion that intermodal competition is “pervasive” for U.S.-Mexico traffic flows is a significant overstatement, directly contradicted by the evidence and Applicants’ own representations made in the course of securing Tex Mex’s trackage rights over UP. To be sure, there are competitive options for *some* of the rail traffic that Tex Mex and UP interchange with TFM at Laredo. Some could be moved by truck, some could be moved to the border by rail and transloaded into trucks for final delivery, and some could be moved by water between points in the United States near ports and points in Mexico readily accessible to Mexican ports, such as Veracruz. The views of the handful of shippers that appeared at the July 31 hearing no doubt reflect the existence of alternatives for *some* shippers.

However, as Mr. Gray explains, these competitive options are by no means “pervasive.” Gray V.S. at 35-38. If they were, the Board would not have had a valid basis for imposing conditions in *UP/SP* designed to protect *railroad* competition at the

Gateway.¹⁰⁶ The Board has regarded competitive rail transportation for NAFTA trade as vitally important precisely because much of the traffic that flows in the corridors anchored by the Laredo Gateway could not move *economically* via other modes.¹⁰⁷

In *UP/SP*, KCS and Tex Mex both emphasized the importance of rail as the only viable means of transportation for many shippers engaged in U.S.-Mexico trade. Tex Mex stressed to the Board that, “[a]lthough most of the transportation of freight between the United States and Mexico is carried by truck, truck and water transportation are not practical alternatives for almost all of the shipments now transported by rail.”¹⁰⁸ Tex Mex contended that the merger “would likely cause a substantial lessening of competition for rail transportation of goods between the United States and Mexico,” because “this is not traffic that can feasibly move by other modes.”¹⁰⁹ Testifying on behalf of Tex Mex, Professor Grimm (who is Applicants’ competition witness in this case) testified that, “[a]lthough truck and water play an important role in transportation of goods between the U.S. and Mexico,

¹⁰⁶ See pages 35-37, *supra*.

¹⁰⁷ As Tex Mex explained to the Board in 1996, “Tex Mex’s arguments and evidence concerning competition [in *UP/SP*] focused primarily on the importance of preserving competition in the market for rail services between the United States and Mexico, because that is the market in which Tex Mex is currently an important participant and because preserving competition in that market is vital to the policies of both countries as reflected in the North American Free Trade Agreement.” *UP/SP*, Tex Mex Petition to Reopen (TM-44) (Sept. 3, 1996) at 4 (Exhibit 16).

¹⁰⁸ *UP/SP*, Responsive Application of Texas Mexican Ry. (TM-23) (March 29, 1996), Verified Statement of Larry Fields at 44 (Exhibit 9). Similarly, Tex Mex’s brief represented that “[s]ignificant volumes of grain and other agricultural products, minerals, woodpulp, paper products, automobiles and automobile parts, and other metals flow through the Laredo gateway. Much of this is bulk traffic that moves long distances and for which truck transport is not a viable alternative.” *UP/SP*, Brief of the Texas Mexican Ry. (TM-39) (June 3, 1996) at 10 (Exhibit 1).

¹⁰⁹ *UP/SP*, Responsive Application of Texas Mexican Ry (TM-23) at 14 (Exhibit 9).

many shippers of many commodities are dependent upon rail competition for competitive transportation options.”¹¹⁰ Similarly, Mr. Grimm explained that “[g]rain is the most important commodity, and there is well-established evidence as to the ineffectiveness for trucks for the long-haul movements of this commodity.”¹¹¹ Another Tex Mex witness opined: “Truck and water competition are not sufficient to constrain significantly rates for rail transportation between the U.S. and Mexico.”¹¹²

KCS (also relying on testimony of Professor Grimm) emphasized the same point in *UP/SP*: “Although truck competition can supplement inadequate intramodal competition for some products and markets, it is not an effective substitute for rail to rail competition Other modes cannot provide an adequate counterbalance for diminution of rail competition in the proposed transaction.”¹¹³

The Applicants’ assertions in this case – echoed with respect to grain by USDA – reach the opposite conclusion only by focusing on highly aggregated data. In essence, they emphasize that much freight moves by truck and water. But examining the traffic flows in particular origin-to-destination markets tells a different story.

¹¹⁰ *Id.*, Verified Statement of Curtis Grimm at 128 (Exhibit 9).

¹¹¹ *Id.* at 129. This view was echoed by the Department of Agriculture in *UP/SP*: “rail is also an important mode of transportation of grain exported overland to Mexico.” *UP/SP*, Comments of the USDA (March 29, 1996) at 3.

¹¹² *UP/SP*, Rebuttal of Texas Mexican Ry. (TM-34), Verified Statement of Joseph Ellebracht (May 10, 1996) at 3 (Exhibit 17); *see also UP/SP*, Responsive Application of Texas Mexican Ry. (TM-23), Ellebracht V.S. at 93 (“Truck competition will not be an effective constraint on rail prices in the absence of effective rail-to-rail competition Water competition will not be a effective constraint on rail prices in the absence of effective rail-to-rail competition”) (Exhibit 9).

¹¹³ *UP/SP*, KCSR Comments and Request for Conditions, Volume I (KCS-33) (March 29, 1996), Grimm V.S. at 208 (Exhibit 18).

As Mr. Gray explains, for most shippers that use rail today, truck and water alternatives are not available. For example, there are no efficient intermodal alternatives available to shippers of bulk commodities – such as Unimin, Badger Mining, and others – whose facilities and customers are not located adjacent to ports. Trucks may offer a theoretical alternative for some shippers. However, as Mr. Gray describes, for most of the major flows of U.S.-Mexico traffic that move by rail today, railroad transportation offers significant and growing cost advantages relative to available truck and water alternatives. Gray V.S. at 35-37.¹¹⁴

Indeed, the fact that so much traffic moved by rail before the privatization of Mexico's railroads in the late 1990's, *despite* the horrible inefficiency of the Mexican rail network at the time (*see* Gray V.S. at 8-9), is a stark reminder of how dependent much traffic is on rail movement. The advantages of rail transportation have only increased with the significant improvements in the efficiency of the Mexican rail system over the past six years. *Id.* at 9. One reflection of this improvement is the drop in TFM's operating ratio, from 93.6 in 1997 to 76.2 in 2002. *Id.*

2. UP's Supposed "Bargaining Leverage" Will Not Prevent KCS Control of Tex Mex and TFM from Having Anticompetitive Effects

Applicants also claim that TFM would not act to adversely affect UP-TFM options because it faces the threat that UP would respond by shifting traffic to another of its Mexican gateways – such as Eagle Pass, served by Ferromex. KCS-16/TM-16 at 20-21.

¹¹⁴ The truck and water alternatives available to some shippers will not protect those who lack equally economical non-rail options. KCS would target its anticompetitive strategies at other UP-TFM traffic. Gray V.S. at 38.

However, as Mr. Gray and Mr. Barkley explain, UP is not in a position to shift large amounts of traffic to gateways served by Ferromex. Laredo is the preeminent gateway for many reasons. *See* pages 35-42, above. Some traffic would be impossible to move via Eagle Pass because it is dependent on TFM's rail network within Mexico, in substantial part due to Ferromex's inferior routes, high trackage rights fees and lack of access to important Mexican points, such as San Luis Potosí, Toluca and much of Monterrey. Gray V.S. at 17-18. For other traffic, UP-TFM routes via Laredo offer important cost and service advantages. Switching gateways would result in a lower level of service for UP's customers. Given UP's 26 percent equity investment in Ferromex since 1997,¹¹⁵ it is reasonable to expect that UP has already shifted to Eagle Pass the traffic that would move most efficiently via that gateway. In recent years, however, UP-TFM traffic via Laredo has grown much faster than UP-Ferromex traffic via Eagle Pass, providing a telling indication of Laredo's advantages. Gray V.S. at 12. For most shippers, other gateways are simply less efficient than Laredo.

Moreover, alternative gateways do not have significant excess capacity. Eagle Pass could not accommodate a substantial amount of new traffic. It would take many years to build up significant infrastructure and develop enough capacity for Eagle Pass to present a serious threat to TFM's traffic volumes at Laredo. Massive investments in new rail capacity and border crossing infrastructure would be needed at Eagle Pass before significant volumes of Laredo traffic could move via Eagle Pass. Many of the decisions

¹¹⁵ By contrast, neither TFM nor its parent Grupo TMM has any equity interest in KCS that would give TFM incentives (absent the control by KCS achieved through this transaction) to favor KCS routings.

about additional investments at Eagle Pass would be in the hands of government and third parties, and there would be considerable uncertainty whether those investments would be made. In addition, a significant shift of traffic to Eagle Pass would strand tens of millions of dollars of investments UP made at Laredo to support efficient UP-TFM cross-border commerce. Gray V.S. at 13-16; Barkley V.S. at 3.

Finally, the fact that UP could divert *some* traffic from Laredo to Eagle Pass when KCS acquires control of TFM would not deter KCS/TFM from implementing strategies aimed at selectively disabling UP-TFM competitive options. KCS will be able to target its strategies against that traffic which is most dependent on the advantages of Laredo and/or TFM. Moreover, having chosen to bring TFM under the control of a UP competitor, KCS rationally will already have accepted the prospect that UP might do what it could to shift traffic to Eagle Pass in order to remove it from potential interference by KCS. There would be no reason for KCS to expect that its strategies would cause additional, incremental shifts of traffic away from Laredo and TFM. Thus, it would be irrational for KCS to pass up opportunities to use control over TFM to raise rates and shift profitable traffic to KCS and Tex Mex routes. Gray V.S. at 38-39.

Applicants' suggestion that they would be deterred from implementing anticompetitive strategies out of fear that UP (or BNSF) traffic would be diverted to other gateways – and thus “away from TFM” – is also belied by evidence that KCS *already has undertaken or plans to undertake* actions that would adversely affect competition. KCS has announced that it plans to increase the rate factors that Tex Mex has quoted to BNSF for international traffic moving via BNSF-Tex Mex-TFM routes. KCS says that it views those rates as “too low” and “inappropriately” priced. The Application explains that the problem

with Tex Mex's rates is that they were set by TFM and Tex Mex – which until now had no incentives to favor KCS – rather than by KCS:

“Because KCSR has been a minority investor in Tex Mex and because TFM and Tex Mex have been responsible for their own pricing and marketing arrangements, there may be some agreements that would not provide adequate revenues to a combined KCSR/Tex Mex system. ... [A]ny agreement that does not provide adequate revenues will be reviewed and, if necessary, cancelled pursuant to the terms of that agreement.”

Application at 26 n.19.

KCS is obviously undeterred by hypothetical diversions of BNSF-Tex Mex traffic to Eagle Pass or to other modes. Its intention to increase the Tex Mex rate factors available to BNSF for movements via Laredo offers a chilling preview of KCS's strategies using its control of TFM. Increases in the TFM factors available to UP would reap even greater profits for a combined KCS/Tex Mex/TFM system, while having much more severe adverse impacts on the transportation options available to shippers.

3. UP Does Not Have a “Chokehold” Over KCS and Tex Mex

In several of Applicants' filings, they claim that KCS and TFM could not give preference to Tex Mex and KCS traffic because UP has a “chokehold” on lines Tex Mex uses.¹¹⁶ Applicants are referring to Tex Mex's operations over UP's track between

¹¹⁶ Applicants' Rebuttal to Comments Filed in Reply to Applicant's [sic] Petition to Establish Procedural Schedule (KCS-6/TM-6) (June 9, 2003) at 28 n.20; *see also* Applicants' Reply to UP's Petition For Declaratory Order (KCS-11/TM-11) (June 23, 2003), at 9 n.5. Applicants similarly claim that UP holds a “trump card” because Tex Mex operates over UP trackage. Supplement at 22.

Beaumont, Texas, and Robstown/Corpus Christi, Texas, under trackage rights the Board granted in *UP/SP*. There is no basis for Applicants' claim.¹¹⁷

Trackage Rights Operations and Dispatching

Tex Mex first blithely suggests that UP "unfairly dispatches Tex Mex trains."¹¹⁸ UP has not discriminated against Tex Mex operations in the past, nor could it do so in the future. The Tex Mex trackage rights operations are subject to extensive protections – including Board oversight – that ensure that UP does not discriminate against Tex Mex trains.

Tex Mex's trackage rights are governed by a detailed set of terms, including a protocol governing UP's dispatching of Tex Mex trains negotiated by UP and Tex Mex personnel in 1996. That protocol is substantially the same as the dispatching protocol governing BNSF's trackage rights granted in the *UP/SP* case, which the Board concluded would ensure that the tenant's service was not "subject to dispatching discrimination by applicants." 1 S.T.B. at 403.

Under the protocol, UP must issue written instructions to its dispatchers that Tex Mex trains are to be dispatched "exactly as if they were trains of the same class of [UP] and given equal treatment with trains of [UP]."¹¹⁹ In evaluating performance of its

¹¹⁷ However, Applicants' recognition that fair and nondiscriminatory use of UP's trackage north of Robstown is important to competition *does* underscore the need for the Board to impose conditions in this case that are no less effective in protecting UP's use of the Laredo Bridge and UP's commercial access to TFM's network via the Laredo Gateway than the trackage rights protocols that guarantee Tex Mex fair and nondiscriminatory use of UP's trackage between Beaumont and Robstown.

¹¹⁸ KCS-6/TM-6 at 28 n.20.

¹¹⁹ Dispatching Protocols, § 3 (Barkley V.S., Exh. C).

dispatchers, UP must consider performance of the Tex Mex trains and effectiveness in cooperating with Tex Mex personnel and meeting Tex Mex service requirements.¹²⁰ Tex Mex has the right to request meetings with UP personnel to discuss any disagreement about compliance with the protocol and to present such disagreements to a Joint Service Committee comprised of the chief transportation officers of UP and Tex Mex.¹²¹ Tex Mex may submit any disagreement to binding arbitration before a neutral official if it is not satisfied with the Joint Service Committee's action.¹²² Ultimately, Tex Mex would be entitled to return to the Board to seek relief if it were dissatisfied with UP's administration of the trackage rights.

UP has never violated the protocol governing movement of Tex Mex trains on UP track or otherwise taken action to disadvantage Tex Mex's trains vis-à-vis UP trains. *Barkley V.S.* at 19-20. As Mr. Barkley explains, from time to time, the sorts of operational problems common to all railroads (*e.g.*, maintenance curfews) have contributed to slow velocities on the track, but these problems have not been specific to Tex Mex. Rather, they have occasionally slowed the movement of both UP trains and Tex Mex trains using the tracks. *Id.* at 19. Contrary to Tex Mex's assertions, however, the impact of delays on these lines falls much more heavily on UP than Tex Mex, in part because UP operates many more trains than Tex Mex over these lines. *See Barkley V.S.* at 21-22 & Exh. D.

Tex Mex has invoked its right to convene the Joint Service Committee only once, in early 2003. At that time, Mr. Barkley met with a KCS official to discuss concerns

¹²⁰ *Id.* at § 12.

¹²¹ *Id.* at § 13.

¹²² *Id.*

about delays Tex Mex trains had experienced while using UP's tracks. Barkley V.S. at 19-20. In addition, in recent months, UP personnel have met with Tex Mex representatives weekly to discuss concerns about individual trains. In each case in which Tex Mex identified a train delay, UP personnel investigated and explained the relevant circumstances to Tex Mex personnel. After reviewing the information provided to them, Tex Mex personnel have not identified any UP violation of the dispatching protocol.¹²³

Operating statistics confirm that Tex Mex trains suffer fewer delays than UP trains in this part of Texas. Mr. Barkley reports that in November 2002 the Spring Dispatching Center (which Tex Mex has been invited to join, but has declined) conducted a four-day study of trains operating on UP's Angleton and Brownsville Subdivisions, parts of which are used by Tex Mex trains operating via trackage rights. This study showed that on average, as among UP, BNSF, and Tex Mex trains, UP trains suffered the most minutes of delay per train, while Tex Mex trains experienced the fewest minutes of delay per train. Barkley V.S. at 21 & Exhibit D.

There is no reason to believe that UP would choose to discriminate against Tex Mex in connection with these trackage rights in the future. UP uses the same lines for

¹²³ Barkley V.S. at 20. Mr. Barkley notes that a major factor causing many Tex Mex crews to expire due to hours of service regulations during movements over the trackage rights is that the Tex Mex crew districts are quite long, much longer than UP's crew districts in this area. *Id.* at 20-21.

Mr. Barkley notes that the UP dispatchers probably give Tex Mex trains better treatment than UP trains as a result of this situation. UP's dispatchers generally attempt to give priority to a train when the crew is about to exceed its hours of service. Because of the length of the Tex Mex crew districts, Tex Mex crews are often in danger of exceeding their hours of service. Since UP's crew districts are shorter, UP crews are less likely to be in this situation and thus the UP trains are less likely to receive priority. *Id.* at 21.

its own trains. Any actions UP took to delay Tex Mex trains would increase congestion on the lines, and this would delay UP trains as well. Barkley V.S. at 21-28. Moreover, Tex Mex could control UP's conduct by enforcing rights under the protocol. As noted above, Tex Mex can raise concerns with UP and seek binding arbitration if it believes UP has violated the protocol. *See* Barkley V.S. at 27. Ultimately, it can seek relief from the Board if it believes the 1996 protocol does not give it the necessary protection in connection with the trackage rights.

In addition, Tex Mex is welcome to participate in the Spring Dispatching Center, the joint command center UP and BNSF established at Spring, Texas in the late 1990s.¹²⁴ Placing a representative at the Spring Center would give Tex Mex a better opportunity to coordinate with the UP dispatchers and head off delays, where possible. Despite previous invitations, Tex Mex has declined to participate at Spring. Barkley V.S. at 20.

Capacity on the Trackage Rights Lines

In arguing that UP has a "chokehold," Applicants also have asserted that UP has not invested in the lines Tex Mex uses and that there is insufficient capacity on the Tex Mex trackage rights lines for Tex Mex to add even one more train.¹²⁵ However, as Mr. Barkley explains, UP's statistics show that there is sufficient capacity on the trackage rights lines and that Tex Mex should be able to add traffic without the need for additional

¹²⁴ Barkley V.S. at 22; *UP/SP, Houston Gulf Coast Oversight*, Decision No. 10, p. 24.

¹²⁵ *See* KCS-6/TM-6 at 28 n.20; KCS Reply to CN Petition to Reopen Decision No. 2 (KCS-16/TM-16) at 22.

investment. *Id.* Indeed, UP's statistics show that the trackage lines are less constrained than UP's line between San Antonio and Laredo, which is UP's route to the Laredo Gateway. *Id.*

In addition, if Tex Mex believes its operations on UP's tracks are limited by a lack of capacity, it could take at least two steps to help alleviate the problem. First, the 1996 trackage rights agreement permits Tex Mex to fund new sidings and other capital improvements on the trackage rights lines, and UP may not veto such proposals. Tex Mex has never invoked this provision, but this continues to be an available option. *Barkley V.S.* at 23-24. UP sold to Tex Mex the old SP Wharton line, which runs between Victoria and Rosenberg. Tex Mex and KCS view the rehabilitation of this line as the "next major capital project on Tex Mex" and they will use it in place of approximately more than 100 miles of trackage rights on UP.¹²⁶ This would shorten Tex Mex's route from Beaumont to Laredo and reduce concerns about delays on the trackage rights lines.¹²⁷

D. Mexico's Regulatory Regime Will Not Prevent KCS Control from Having Anticompetitive Consequences

In their Supplement, Applicants misleadingly suggest that provisions of Mexican law and TFM's Concession will prevent TFM from engaging in the type of discriminatory conduct that would harm shippers who use UP.¹²⁸ Francisco Fuentes Ostos, Mexican counsel experienced in rail matters, explains in his verified statement that Mexican law and regulation will not effectively prevent such anticompetitive behavior. As Mr. Fuentes explains, Mexico's rail regulatory regime is still in its infancy, which means that

¹²⁶ Supplement, *Riney V.S.* at 141.

¹²⁷ *Barkley V.S.* at 24.

¹²⁸ See Supplement at 29-30.

courts and regulators have had almost no occasion to interpret or enforce the relevant provisions of Mexican railroad law. It is thus unclear how courts and regulators would respond to complaints of discriminatory treatment following KCS control. The only certainty is that disputes would take years to resolve. *Fuentes V.S.* at 2.

Moreover, Mexican law would not prevent KCS/Tex Mex/TFM from engaging in one of the key tactics for exploiting common control described by Messrs. Gray and Hausman: raising TFM rates between Laredo and TFM-served points on a non-discriminatory basis, with KCS selectively reducing its rates for its U.S.-Mexico traffic. Mexican law does not place any practical limits on how high TFM could raise its rates within Mexico in order to carry out this strategy. *Id.* at 3.¹²⁹ The law does contain various provisions that purport to require TFM to set rates in a non-discriminatory manner. *See id.* at 4. However, as Mr. Fuentes explains, Mexican authorities likely would not address the overall TFM/Tex Mex/KCS rate. They would consider only whether the *TFM portion of the rate* was offered to all shippers in a nondiscriminatory manner. *See id.* Thus, a strategy involving the use of across-the-board rate increases with (partially) offsetting rate reductions in the United States probably would not be actionable. *See id.* at 3.

Mexican law does purport to prohibit discriminatory behavior by TFM. But KCS/Tex Mex/TFM likely will not be deterred by potential enforcement of Mexican regulatory provisions against TFM discrimination as to matters of operations and service. The Mexican Secretary of Communications and Transport (“SCT”), which is charged with

¹²⁹ As Mr. Fuentes explains, Mexican law contains procedures through which certain parties theoretically could challenge a carrier’s maximum rates, but no rate has ever been challenged using those procedures, and there are many questions about how they would apply. *See Fuentes V.S.* at 3-4.

enforcing these laws, has never had occasion to rule on a dispute involving an allegedly discriminatory practice. *Id.* Thus, there are many unanswered questions about how the SCT would interpret the applicable provisions. *Id.* In fact, according to Mr. Fuentes, it is unclear whether the anti-discrimination provisions would even apply to discrimination by TFM between KCS/Tex Mex and other U.S. connecting carriers if TFM came under KCS control. *Id.* at 5.

Even if UP or affected shippers could in theory successfully challenge discriminatory conduct by TFM, the process for obtaining a favorable SCT resolution, and then enforcing it against TFM, would likely involve years of protracted litigation before administrative agencies and courts in Mexico. *See id.* at 6. All resolutions issued by Mexican administrative agencies such as the SCT are subject to complicated appeal and review by Mexican courts – and can be blocked by “*amparos*” (a type of injunction) filed by parties seeking to delay resolution. *Id.* The judicial process can last years longer than in the U.S., especially where untested issues of law are involved. *Id.*

One illustration of the difficulty in obtaining and then enforcing SCT resolutions is Ferromex’s attempt to enforce certain provisions of the TFM Concession. As Mr. Fuentes explains, Ferromex’s efforts to obtain an SCT ruling enforcing TFM’s obligation to grant Ferromex access to certain shippers in Monterrey began on July 4, 2001 after years of unsuccessful negotiation. More than a year later, on August 7, 2002, the SCT issued a resolution requiring that TFM grant access under specified terms and conditions. TFM then obtained a court order that suspended the SCT’s resolution and prevented Ferromex from exercising the rights granted to it by the SCT. The suspension still remains in effect. *See id.* at 7. This experience is typical of efforts to enforce TFM’s Concession

and applicable railroad regulations. *See id.* Just as TFM has successfully used “*amparos*” to block full realization of Mexico’s privatization plan, KCS/TFM likely could delay for years attempts to enforce Mexican law against its discriminatory practices.

Mexican law thus cannot realistically protect U.S. shippers against the anticompetitive effects of KCS control on traffic moving between the United States and TFM-serviced points in Mexico.

IV. THE BOARD SHOULD IMPOSE CONDITIONS AIMED AT PROTECTING COMPETITION VIA THE LAREDO GATEWAY

To ensure that this transaction does not substantially lessen competition, the Board must fashion conditions that will preserve effective competition for traffic moving over the Laredo Gateway. In order for UP to offer competitive service for U.S.-Mexico rail traffic moving through the Laredo Gateway in competition with a consolidated KCS/Tex Mex/TFM, it must have the continued cooperation of TFM in providing shippers with competitively-viable rates between the U.S. and Mexico (*i.e.*, the gateway must remain open on commercially reasonable terms); it must have the continued cooperation of TFM on all the aspects of service that are required to make UP-TFM offerings competitively viable; and UP’s cross-border traffic must receive fair treatment at the Laredo Bridge. Each of these elements is interdependent,¹³⁰ and each is threatened by KCS control of Tex Mex and TFM.

¹³⁰ UP’s ability to quote competitive rates would mean nothing if it could not promise its customers efficient service on TFM within Mexico or if its trains were hindered by Tex Mex in crossing the Laredo Bridge. Similarly, UP’s ability to provide efficient service for U.S.-Mexico cross-border traffic would mean nothing if it could not offer its customers competitive rates within Mexico or assure them that their traffic will receive equal treatment at the Bridge. Finally, UP’s access to the Bridge would mean nothing if it could not offer its

(footnote continued ...)

Applicants' three sets of commitments (*see* page 11, above) are the starting point – but only the starting point – for effective remedial measures that would avoid the threat to competition posed by unconditioned KCS control of Tex Mex and TFM. Standing by themselves, however, Applicants' commitments will not suffice. They lack definition in crucial respects, and they would be utterly unenforceable unless imposed as conditions in this case. Without concrete and enforceable agreements, Applicants will act in accord with their powerful incentives to enhance profits by using control of Tex Mex and TFM to interfere with the competition provided by efficient UP-TFM transportation options.

Converting Applicants' commitments into effective remedial measures is not complicated, and the Board has ample authority to achieve this aim. UP is asking the Board to take three simple steps:

1. Require Applicants, as a condition of Board approval of this transaction, to abide by the commitments they have made in this proceeding;
2. Require them to negotiate in good faith with UP (and other interested parties) to develop agreements that would implement their commitments in effective and enforceable ways, as they have said they are willing to do (with Board guidance as to the objectives of such implementing arrangements where appropriate); and

(... footnote continued from previous page)

customers competitive rates and efficient service on UP-TFM international routes between the United States and Mexico.

3. Retain jurisdiction to resolve disputes and impose appropriate implementing arrangements should the parties fail to reach agreement within a reasonable period of time, perhaps 90 days.¹³¹

Each of these steps is consistent with Applicants' own promises, and with the Board's broad remedial authority. Each is also consistent with the need to protect competition without interfering with the Applicants' legitimate interests in pursuing pro-competitive efficiencies and other improvements that may one day stem from their proposed common control. UP proposes specific language that the Board could impose in Exhibit 19.

At the July 31 hearing, KCS's Gerald Davies complained that Board-imposed conditions would require KCS to negotiate agreements implementing its promises with a "gun to its head." But unless KCS does not intend to negotiate in good faith over effective and enforceable measures to implement its commitments, it has nothing to fear from Board oversight. If parties other than KCS make overreaching demands, UP would expect the Board to favor KCS's position rather than that of its opponents.

The alternative to Board involvement is unacceptable. If the Board did not reserve the ability to impose an appropriate implementing arrangement in the event the

¹³¹ This is the Board's standard approach. For example, in *Conrail*, the Board required parties to negotiate agreements implementing various conditions and stated that it would initiate a proceeding if the parties failed to reach an agreement. *Conrail*, 3 S.T.B. at 388-89 (Condition No. 28: requiring negotiations over an agreement to grant CP haulage or trackage rights and stating that the Board will initiate a proceeding to address the matter if the parties have not reached an agreement); *id.* at 391 (Condition No. 64: requiring negotiations over an agreement to grant NECR trackage rights and setting a date for the parties to submit final proposals if negotiations are not fully successful). Similarly, in *UP/SP*, the Board required UP and Tex Mex to negotiate agreements implementing the Board's trackage rights condition, and it resolved several disputed issues when the parties failed to reach agreement on every term. *UP/SP*, 1 S.T.B. at 425; *UP/SP*, Decision No. 47, 1 S.T.B. 591 (1996).

parties fail to agree, there likely would be no agreement. KCS's incentives would be to reserve maximum flexibility for itself, requiring shippers and other affected parties to rely on KCS to act against its self-interest and refrain from the anticompetitive actions that common control of Tex Mex and TFM would allow.

A. The Board Has Authority to Impose Conditions to Mitigate Potential Anticompetitive Effects of the Transaction

The Board “has broad authority to place conditions on approval of [railroad control] transactions.”¹³² That authority is provided by 49 U.S.C. § 11324(c), which grants the Board authority impose conditions that are in the public interest in connection with approval of a transaction.¹³³ That authority applies to all control cases, including those governed by 49 U.S.C. § 11324(d). In cases under § 11324(d), the Board must grant the application unless there “likely” will be “substantial” adverse competitive impacts.¹³⁴ But the Board also has an obligation to mitigate such effects “through conditions” that serve the public interest.¹³⁵ In this case, UP’s witnesses demonstrate that unconditioned approval likely would pose a substantial threat to competition for international traffic moving via the Laredo Gateway. The imposition of conditions to mitigate those effects is plainly warranted.

¹³² CN/WC at 10 n.18; see also *Dakota, Minnesota & Eastern R.R. & Cedar American Rail Holdings, Inc. – Control – Iowa, Chicago & Eastern R.R.*, STB Finance Docket No. 34178 (STB served Feb. 3, 2003) at 13 n.32.

¹³³ *Lamoille Valley R.R. Co. v. ICC*, 711 F.2d 295, 300 n.3 (D.C. Cir. 1983).

¹³⁴ CN/WC at 10.

¹³⁵ *Kansas City Southern Industries, Inc., KCS Transportation Co. & The Kansas City Southern Ry. – Control – Gateway Western Ry. & Gateway Eastern Ry.*, STB Finance Docket No. 33311 (STB served May 1, 1997) at 4; see also CN/WC at 10; *Dakota, Minnesota & Eastern R.R. & Cedar American Rail Holdings, Inc. – Control – Iowa, Chicago & Eastern R.R.*, STB Finance Docket No. 34178 (STB served Feb. 3, 2003) at 13.

There is another basis for imposing conditions in cases such as this one, where Applicants have made commitments on the record designed to forestall competitive concerns. The Board's routine policy is to require that applicants abide by their representations during the course of the proceeding as a condition of approval. For example, in *CN/WC*, another "minor" transaction, the Board imposed as a condition that "Applicants must adhere to all of the representations they made on the record during the course of this proceeding."¹³⁶ The Board has specifically required applicants to abide by commitments to keep open gateways on commercially reasonable terms. For example, in *CN/WC*, the Board stated that it would "hold applicants to [their] representation" to "keep all existing active gateways affected by the Transaction open on commercially reasonable terms."¹³⁷ In this proceeding, Applicants have made various substantive commitments on the record, and they have also said that they are willing to negotiate agreements to implement those commitments.

UP's proposed conditions are consistent with the Board's criteria. Ameliorative conditions must: (1) be "operationally feasible," (2) "ameliorate or eliminate the harm," and (3) "result in greater benefit to the public than detriment to the transaction." See *Grainbelt Corp. v. STB*, 109 F.3d 794, 796 (D.C. Cir. 1997). As explained further

¹³⁶ *CN/WC* at 28; see also *CN/IC* at 57 ("Applicants must adhere to all of the representations they made on the record during the course of this proceeding . . ."); *Conrail*, 3 S.T.B. at 387 ("Applicants must adhere to all of the representations they made during the course of this proceeding . . .").

¹³⁷ *CN/WC* at 13. The Board also held applicants to their commitment "to work directly with connecting carriers" to establish rates for movements over affected gateways. *Id.*; see also *CN/IC* at 37 ("[W]e will impose a condition holding applicants to their representation to keep [the CP/IC] gateway open and competitive.").

below, UP's proposal that the Board hold Applicants to their commitments in this proceeding meets each of these standards. It allows the Board to achieve an ideal outcome in this case: protecting competition at the vital Laredo Gateway while simultaneously allowing Applicants to pursue whatever pro-competitive efficiency gains common control might create (however unlikely those efficiencies may be, as discussed above).

B. The Board Should Implement Applicants' Commitments by Imposing Narrowly Tailored Conditions

The commitments Applicants have offered during the course of this proceeding reflect their recognition that a consolidated KCS/Tex Mex/TFM will have new incentives and abilities to harm competition for rail traffic moving over the Laredo Gateway. However, the potential for harm will remain unchecked if the Board does not require Applicants to abide by their commitments and implement them through enforceable agreements. UP's proposed framework for implementation will accomplish this aim with respect to each of Applicants' important commitments.

1. Keeping the Laredo Gateway Open on "Commercially Reasonable Terms"

Applicants have pledged "to keep the Laredo gateway open on commercially reasonable terms."¹³⁸ They have also stated that they are "willing to enter into private discussions with UP or any other party to discuss this commitment and reach a private agreement to ensure that [they] abide[] by this commitment."¹³⁹

¹³⁸ Supplement at 24.

¹³⁹ Applicants' July 21 Letter (Exhibit 2).

This is a good start. However, Applicants have never explained how they would define “commercially reasonable terms” or how they would ensure that UP and others that depend on the Laredo Gateway have access to such terms. Nor is there any mechanism for enforcing this crucial promise. Thus, even if it imposes Applicants’ basic commitment as a condition, the Board cannot be confident that rail carriers other than KCS and its partners will be able to offer competitive rates for U.S.-Mexico movements via Laredo in conjunction with TFM.

Shippers should not have to rely on Applicants’ nebulous commitment to keep the Laredo Gateway open. In addition to requiring Applicants to abide by their basic commitment to keep the Laredo Gateway open on commercially reasonable terms, the Board should require them to negotiate in good faith with UP to develop an agreement that ensures that the gateway will remain open on commercially reasonable terms. In *Major Rail Consolidation Procedures*, the Board concluded that “major existing gateways should be kept open in future mergers.”¹⁴⁰ The Board required future applicants to “present an effective plan to keep open major existing gateway” and stated that it would “impose conditions on any transaction that [it] approve[s] to ensure that result.”¹⁴¹ Even if this case does not technically involve a “major” transaction, the Laredo Gateway is plainly a “major existing gateway” worthy of protection.¹⁴² Even in minor cases, and even where it has not formally found any anticompetitive effects, the Board has imposed conditions aimed at

¹⁴⁰ *Major Rail Consolidation Procedures* at 25.

¹⁴¹ *Id.*

¹⁴² See *CN/WC* at 20 (noting that “applicants have provided a Service Assurance Plan, usually required for major transactions”).

protecting gateways. The Board should require Applicants to negotiate with UP to develop an agreement that effectively preserves competition for traffic moving over the Laredo Gateway. If a suitable agreement could not be reached within a reasonable period of time (perhaps 90 days), the Board should conduct further proceedings to develop and impose an appropriate condition.¹⁴³

There is no doubt that a workable arrangement could be arrived at if both sides are motivated to negotiate constructively. UP believes that there are only two basic requirements of any implementing agreement:

- First and foremost, the agreement would have to include some mechanism that provided UP (and other carriers) with the ability to offer shippers competitively-viable services in conjunction with TFM, including TFM commercial terms (*e.g.*, rates, rate factors, etc.) that would allow (but not guarantee) UP-TFM rates on cross-border shipments to remain competitive.
- Second, it must ensure that KCS/Tex Mex/TFM have sufficient flexibility to adjust their rates to reflect transaction-related efficiencies.

There may be a variety of mechanisms available to achieve these goals. In *Major Rail Consolidation Procedures*, UP recommended that the goal of preserving gateways be implemented by requiring that combining carriers make available at a shipper's request separately challengeable "bottleneck" rates between exclusively-served facilities on their system and the affected gateway.¹⁴⁴ The ability to challenge the "bottleneck" rates would ensure that rates were reasonable, and applicants would have flexibility to adjust their

¹⁴³ See, *e.g.*, *UP/SP*, 1 S.T.B. at 425.

¹⁴⁴ UP's Comments on Proposed Merger Rules in *Major Rail Consolidation Procedures*, STB Ex Parte No. 582 (Nov. 17, 2000) at 13, 32-34 (Exhibit 20).

rates, subject to reasonableness constraints.¹⁴⁵ However, UP's proposal could not be implemented here, where the Board is not in a position to apply its stand-alone cost methodologies to TFM rates in Mexico, and there is no effective maximum rate regulation in Mexico.¹⁴⁶

One potentially effective approach may be a form of "proportional rate" agreement modeled on the I-5 Proportional Rate Agreement between UP and BNSF approved by the Board in the *UP/SP* merger.¹⁴⁷ As Mr. Gray explains in his Verified Statement, the I-5 Agreement has a proven track record of preserving competition for traffic moving over the Portland Gateway. *Gray V.S.* at 43.¹⁴⁸ It was adopted to address a situation very similar to that present here: BNSF was acquiring former-UP trackage that gave it a new single-line route between the BNSF-served points in the Pacific Northwest and points in Southern California and the Southwest. SP had long had its own single-line route between Portland and the Southwest, but relied on joint-line cooperation from BNSF to serve points in Washington, Idaho and western Canada. UP was concerned that BNSF would discontinue cooperation with UP once it acquired its own single-line route, thereby depriving BNSF-served shippers of the benefits of competition from a second carrier. The I-5 Agreement remedied this problem by establishing a matrix of rate factors that UP could use to compete head-to-head with BNSF single-line routes (albeit on a joint-line basis with the continued cooperation of BNSF). *Id.* at 42-43. The I-5 Agreement has allowed UP to

¹⁴⁵ *Id.* at 34-35.

¹⁴⁶ *See Fuentes V.S.* at 3-4, 6.

¹⁴⁷ *UP/SP*, 1 S.T.B. at 253-54, 419.

¹⁴⁸ The I-5 Agreement is Gray Exhibit M.

compete, while simultaneously allowing BNSF to grow its traffic using its new single-line routes. The Agreement has not frozen the status quo. *Id.* at 43.

An agreement modeled on the I-5 Agreement could effectively implement the goal of preserving the Laredo Gateway on commercially reasonable terms. UP believes that an adaptation of that agreement to the Laredo setting would preserve its essential elements, as set forth in Gray Exhibit C, although these and all other issues would be open for negotiation with Applicants.

Such an agreement would meet the first essential requirement of an effective gateway condition – it would create a mechanism for obtaining reasonable TFM rate factors. The rate factors would be reasonable because they would be derived from rates that are actually moving traffic – that is, TFM-Tex Mex-KCS origin-destination rates for similar traffic.

It would also meet the second essential requirement – it would not prevent Applicants from adjusting their rates to reflect merger efficiencies. In *Major Rail Consolidation Procedures* and other cases,¹⁴⁹ the Board properly expressed concern about imposing “rate equalization” conditions reminiscent of those developed in *DT&I Control*¹⁵⁰ and later repudiated in *Traffic Protective Conditions*.¹⁵¹ “DT&I conditions,” which formerly were imposed almost automatically and identically in every merger proceeding, essentially required consolidated railroads to freeze in place the relationships with other railroads that

¹⁴⁹ See, e.g., *CN/IC* at 37.

¹⁵⁰ *Detroit, Toledo & Ironton R.R. Control*, 275 I.C.C. 455 (1950).

¹⁵¹ *Rulemaking Concerning Traffic Protective Conditions in Railroad Consolidation Procedures*, 366 I.C.C. 112 (1982).

existed before the merger at every interchange point on their systems, no matter how inefficient.¹⁵² The ICC interpreted the conditions to require “rate equalization.” This meant that a consolidated carrier “was generally prohibited from maintaining rates on its new single-line routings resulting from consolidation below the rates on any competing joint-line routes in which it participated.”¹⁵³

The *DT&I* conditions were problematic because they eliminated consolidating carriers’ incentives to reduce rates for their new single-line routings by prohibiting them from offering origin-to-destination rates below those available for competing joint-line routes. Consolidating carriers could not reduce rates to reflect merger efficiencies without first negotiating with connecting carriers to ensure that equal rates would be offered over all competing origin-to-destination routes.¹⁵⁴ Consolidating carriers had no choice but to keep rates high enough to cover the costs of less efficient-joint line movements in the event that shippers, who would have no monetary incentive to chose the more efficient route, chose a joint-line option.¹⁵⁵ Moreover, *DT&I* conditions were applied at every interchange point without regard to whether the joint-line relationship being preserved were efficient ones at major gateways or inefficient ones at minor, little-used junctions.¹⁵⁶

¹⁵² See *id.* at 112. The ICC had imposed similar traffic protective conditions on mergers since the 1920’s. In *Detroit, Toledo & Ironton R.R. – Control*, 275 I.C.C. 455, 492 (1950), these conditions were distilled to a set of six standard conditions.

¹⁵³ *Id.* at 13.

¹⁵⁴ See *Traffic Protective Conditions*, 366 I.C.C. at 121-22.

¹⁵⁵ See *id.* at 123.

¹⁵⁶ See *id.* at 122.

An agreement modeled on the I-5 Agreement would easily avoid these concerns. It would be narrowly tailored to solving the competitive problems UP has identified without interfering with Applicants' ability to become more efficient and compete with UP. As Mr. Gray explains, it would not involve rate equalization. It would provide a process for developing rate factors that Applicants could not manipulate to disable UP competition, but Applicants would remain free to charge shippers using their own single-system routes whatever they wished without seeking UP's concurrence. UP would never learn what rate Applicants were offering for a particular customer or route, as the rate factors would be based on aggregated and averaged data prepared by a third party. Gray V.S. at 45.

Moreover, Applicants would have strong incentives to realize efficiencies from their transaction in order to reduce rates and compete against UP. The TFM rate factor available to UP would always lag behind changes in the rates that Applicants were offering. UP's proposal contemplates only quarterly adjustments to the TFM rate factor, and the adjusted factor would reflect *all* comparable traffic moving in the previous quarter, not just new movements. Thus, Applicants would always be able to offer shippers a lower rate per-ton-mile than is reflected in the TFM rate factor available to UP, if they continued to reduce costs. There could be no stronger incentive for Applicants to improve their efficiency as a means of competing with UP. *Id.* at 45-46.

Furthermore, there would be no danger that Applicants would be deterred from reducing rates to reflect their own single-line efficiencies out of concern that they will end up subsidizing inefficient interchange operations at inefficient gateways. First, the condition would apply only to the Laredo Gateway, which is plainly an efficient gateway.

Second, UP and TFM already have a highly efficient interchange at Laredo. Third, KCS/Tex Mex and TFM do not expect to achieve any additional operational efficiencies at the Laredo Gateway as a result of the transaction. As we discuss above, they already tout their “seamless” service, and they have stated that KCS control of TFM is not expected to result in any operational changes.

UP has considered the remedial options suggested by other recent transactions, but these approaches would not resolve the competitive issues in this case. For example, in *Conrail*, CSX and NS agreed “to keep open all major interchanges with other carriers as long as they are economically efficient.”¹⁵⁷ That type of broad, vague commitment may have sufficed where no party had demonstrated the competitive harms associated with closing a particular efficient gateway, but where specific harms have been identified, an effective plan for addressing that harm is warranted, as the Board concluded in *Major Rail Consolidation Procedures*.¹⁵⁸

In *CN/WC*, the applicants made a similar open gateway pledge.¹⁵⁹ They also entered into an agreement with NIT League to establish commercially reasonable contract through rates for all active gateways on request and to freeze their portion of common carrier through rates for five years.¹⁶⁰ However, as in *Conrail*, the Board never found that a

¹⁵⁷ *Conrail*, 3 S.T.B. at 255.

¹⁵⁸ *Major Rail Consolidation Procedures* at 25.

¹⁵⁹ *CN/WC* at 13.

¹⁶⁰ *Id.* at 12.

condition was appropriate to address potential competitive harms; it simply required the applicants to abide by their commitments.¹⁶¹

A short-term rate freeze or other short-term remedy would not be effective in this case.¹⁶² In situations where carriers have multiple gateway options, a short-term remedy may be sufficient, because it would allow potentially affected carriers to develop new routes before one of those options is closed. That is not the situation here, where Laredo is and will for the foreseeable future remain indispensable to much U.S.-Mexico rail commerce. A short-term solution would merely postpone temporarily the adverse competitive effects of the transaction.

2. Enforceable Commitments Regarding Non-Rate Forms of TFM Cooperation for Movements Via Laredo.

Applicants have pledged “to continue to work with both UP and BNSF” with respect to traffic moving between the U.S. and Mexico.¹⁶³ They have committed “to seeing that UP and BNSF are provided the same level of service that they have experienced in the past, and to making improvements on that level of service where possible.”¹⁶⁴ They have also committed to “use [KCS’s] control of TFM . . . to require TFM to cooperate with both UP and BNSF on pre-blocking cars, improving automated customers pre-clearance procedures, supplying cars for shipments, accommodating run-through train service,

¹⁶¹ *Id.* at 13-14.

¹⁶² Applicants’ vague promise to keep the gateway open on “commercially reasonable terms” is no more effective than CN’s longer-term commitment to provide “commercially reasonable contract through rates” (*id.* at 12). It would leave unresolved the question of what was “commercially reasonable.”

¹⁶³ Supplement at 25.

¹⁶⁴ Applicants’ July 21, 2003 Letter (Exhibit 2)

providing excellent service, and promptly quoting rates.”¹⁶⁵ And they have committed “to work with UP and BNSF on development of a methodology for measuring service standards and to develop a method by which such standards could be enforced.”¹⁶⁶

In making these commitments, Applicants have appropriately recognized that continued strong competition for U.S.-Mexico traffic depends on the ability to UP and other railroads to offer their customers competitive service as well as competitive rates. UP’s competitive concerns relating to TFM service would be met if Applicants abided by these commitments. However, until the parties develop a methodology for measuring service standards and develop a method by which such standards could be enforced, neither the parties nor the Board will be able to assess whether Applicants are living up to those commitments.

In addition to requiring Applicants to abide by their various commitments to work with UP to maintain and improve current service levels, the Board should require them to negotiate in good faith to develop a methodology for measuring service standards and to develop a method by which such standards could be enforced. Like the proposed Gateway Condition, this Service Condition would implement Applicants’ various service commitments without interfering with any potential benefits arising from KCS control of Tex Mex and TFM. Applicants have repeatedly asserted that they will have “every

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

incentive to preserve other carriers' access to and efficient operation with TFM."¹⁶⁷ Thus, there is no conceivable harm in holding Applicants to their service commitments.

Moreover, Applicants' efforts to achieve efficiencies would not be hindered by a requirement that they agree upon methodologies for measuring and enforcing service standards. As Mr. Gray explains, UP and BNSF developed effective methodologies for measuring service performance in the context of the *UP/SP* merger. Gray V.S. at 49. The Board has also required post-approval operational monitoring in other recent transactions.¹⁶⁸ The parties should be able to use these examples as the basis for developing methodologies suitable to this transaction. The Board would thus have a firm basis on which to act in the unlikely event that the parties were unable to reach a negotiated agreement within a reasonable period of time. Again, if a suitable agreement could not be reached within a reasonable period of time (perhaps 90 days), the Board should conduct further proceedings to develop and impose an appropriate condition.¹⁶⁹

3. The Laredo Bridge

Finally, the Board should impose a Bridge Condition as a condition in this case. Applicants have represented that they would accept a condition holding them to their

¹⁶⁷ Supplement at 25.

¹⁶⁸ See *Conrail* at 55; *CN/WC* at 19-22. In *Major Rail Consolidation Procedures*, the Board imposed new requirements that applicants provide service benchmarks and indicated that it will conduct significant post-approval operational monitoring. *Major Rail Consolidation Procedures* at 40, 62-65; 49 C.F.R. §§ 1180.1(h), 1180.10(k).

¹⁶⁹ Again, this comports with the Board's standard practice. See note 131, *supra*.

commitments respecting the Laredo Bridge, including a requirement to negotiate a new bridge operating protocol.¹⁷⁰

As Mr. Barkley explains, UP believes that a new Bridge protocol should accomplish three key objectives, and UP urges the Board to provide guidance to the parties that would ensure that their implementing agreement meets these criteria:

- First, it should establish a joint operations center that would control operations on the Laredo Bridge and the trackage approaching the Bridge. Establishing such a center would give UP a formal role in decisions about Bridge operations and priority for movements over the Bridge. Joint dispatching centers have proved to be a highly successful way to administer trackage used by more than one railroad, ensuring neutral treatment of the trains of each railroad. The joint dispatching operations of UP and BNSF for the Houston area and other congested terminals are prime examples of how well such centers have worked. Barkley V.S. at 15-16.¹⁷¹

¹⁷⁰ See Applicants July 21 Letter (Exhibit 2). Applicants had previously suggested that conditions pertaining to the Laredo Bridge were not warranted because operations were governed by pre-existing agreements. Supplement at 26-27. Applicants, however, ignore the effect that KCS control of Tex Mex would have on Tex Mex's incentives to interpret and apply those agreements in a manner that protected competition via the Laredo Bridge. There is precedent supporting the imposition of conditions to address potential effects caused by changes in carriers' incentives with respect to the implementation of pre-existing agreements. See *Union Pacific Corp. – Control – Chicago & North Western Transportation Co.*, Finance Docket No. 32133 (ICC served Mar. 7, 1995) at 90 (imposing condition precluding CNW from withholding consent to potential assignments by Soo Line of its rights to operate over the Polo Line (between Kansas City and Polo, Missouri) under a longstanding trackage rights/ paired track agreement because "common control will broaden the circumstances in which CNW will have reason to exercise its veto power").

¹⁷¹ The Board has recognized these benefits. See *UP/SP Houston/Gulf Coast Oversight*, Decision No. 10 (STB served Dec. 21, 1998) at 11, 25-26.

In view of the extensive efforts the three railroads have already made to coordinate their operations at the Bridge, establishment of a joint command center should not be a burden for TFM and Tex Mex. In fact, such a condition is likely to yield greater efficiency in Bridge operations and thus more capacity for all three railroads.

- Second, the new protocols should require the railroads to manage Bridge operations in a manner that will achieve non-discriminatory and efficient operation of the Bridge. Such a provision would enable the railroads to invoke a formal obligation ensuring that each continues to participate in practices that maximize the total capacity and operating efficiency of the Bridge and that do not favor any one user.

- Third, the new protocols should establish a methodology for allocating Bridge capacity that is proportionate to each railroad's share of traffic at the Laredo crossing at any given time. As explained above, UP is concerned that the NAFTA Rail carriers will attempt to impose a 50-50 allocation of priority slots for Bridge crossings. Such a one-for-one protocol would guarantee superior treatment for the carrier with less traffic – and in substance impose an anticompetitive market allocation – since it would receive half of the available slots, while the carrier with the majority of the traffic would receive all of the lowest priority slots. As a result, when there are more trains waiting than can be accommodated during a window, the carrier that enjoys greater market demand for its services would always be the one that is unable to cross all of its trains during that window. The result would be to diminish service levels for the railroad that currently has the majority of the traffic, in this case UP. UP recognizes, of course, that this principle would not create any entitlement to any particular share of Bridge capacity: each party's share would fluctuate with its volume of traffic. If Tex Mex-TFM crossings came to exceed those of UP

as a result of legitimate competitive forces, UP would accept that Tex Mex should be entitled to more than half of the available slots. Barkley V.S. at 16-18.

C. The Proposed Conditions Are Consistent With the Board's Policy Towards End-to-End Transactions

Although Applicants have asserted that it would be inappropriate to impose conditions on their end-to-end transaction, UP's requests for conditions are fully in accord with Board policy for at least three reasons.

First, UP has demonstrated that Applicants' transaction is likely to cause a substantial lessening of competition. UP believes that end-to-end consolidations typically present much less risk of harm than parallel consolidations, but they can nonetheless give rise to anticompetitive effects in certain circumstances. In this case, Applicants will have the ability and the incentives to increase the rates shippers pay or reduce the quality of service they receive in order to generate more revenues for KCS/Tex Mex/TFM. The evidence shows that Applicants' control of the Laredo Gateway and their ability to alter the existing relationship between U.S. carriers and TFM will create opportunities for KCS/Tex Mex/TFM to undermine the competitive process and thereby harm shippers. Hausman V.S. at 9-18. The Board has made it clear that in such circumstances it will exercise its broad conditioning authority in order to reduce the risks to competition.

Second, Board policy recognizes the potential for competitive harm that end-to-end transactions create at major gateways and affirmatively seeks to prevent those harms. In most end-to-end transactions in the past, concerns about closing gateways were unwarranted. In most instances, the transaction eliminated only one of many potential connections at a gateway, and it did not affect the many alternative combinations of gateways and connections that were equally able to compete for the same business.

However, as the Board and UP have recognized, as more and more consolidation have occurred, situations now exist in which the commercial closure of a gateway would pose genuine competitive concern. The risk of closure and the potential for anticompetitive harm are as great as in any major transaction, because the transaction involves the only connection on one side of the gateway, and alternative U.S.-Mexico gateways are not adequate substitutes for the Laredo Gateway.¹⁷² Thus, the Board's policy as expressed in *Major Rail Consolidation Procedures* not only recognizes that end-to-end mergers may present competitive concerns, it would require a gateway-preservation condition in this case.

Third, Applicants have made significant, on-the-record commitments not to engage in discriminatory conduct with respect to rates and service for traffic moving over the Laredo Gateway. As we have shown, the Board's uniform practice has been to impose such commitments as conditions. *See* page 89, above. The Board's policy of holding applicants to their commitments is the same for major and minor transactions, whether they are largely parallel or largely end-to-end.

Applicants have tried to suggest that those conditions would be vastly overreaching. They have implied that UP is seeking to equalize rates for movements over the Laredo Gateway, require special treatment for UP's shipments within Mexico, and freeze the competitive conditions at Laredo. However, as UP has always made clear, it wants none of that.¹⁷³ UP does not wish to constrain any efforts by Applicants to provide

¹⁷² *See* Gray V.S. at 12-20.

¹⁷³ For example, in response to a letter sent by Applicants seeking clarification of UP's position regarding appropriate relief in this case, UP explained in detail why its proposals for implementing Applicants' commitments would allow Applicants to take advantage of

(footnote continued ...)

shippers with more efficient competitive alternatives. Rather, UP is seeking concrete and enforceable conditions that will prevent Applicants from exercising their new, post-consolidation abilities and incentives act anticompetitively to impede effective competition by UP for movements between the U.S. and Mexico. UP is asking for nothing more than a binding set of requirements holding Applicants to the commitments they have already made on the record in this proceeding.¹⁷⁴ Board policy is fully in accord with that request.

V. CONCLUSION

This case will be the Board's only opportunity to ensure the preservation of rail competition for traffic moving to and from the United States over the most important U.S.-Mexico Gateway. Control of Tex Mex is the linchpin in a transaction that will give KCS control of both the Laredo Gateway and the only Mexican railroad that serves that gateway, which until now has cooperated with both U.S. railroads at Laredo on an equitable basis.

The Board plainly has jurisdiction to address competition for rail traffic moving over the Laredo Gateway in this case. In *UP/SP*, the Board imposed remedies for the sole purpose of preserving competition for this traffic. Applicants have asserted that the Board's jurisdiction in this case is confined because they severed Tex Mex from TFM and placed shares in a voting trust before filing their Application. But that maneuver does not

(... footnote continued from previous page)

their improved efficiencies, if any, in competing for traffic moving via Laredo. See Letter from David L. Meyer to William A. Mullins, dated July 30, 2003 (Exhibit 21).

¹⁷⁴ See *id.*

affect the Board's responsibility to consider the impacts of the broader transaction on competition for traffic within the United States

The likely anticompetitive impacts are clear. Unless the Board conditions its approval, this transaction is likely to result in a the substantial lessening of competition for rail service between the United States and Mexico. UP and other railroads depend on Tex Mex and TFM for physical access to the Laredo Bridge and on TFM for commercial access to points in Mexico. However, as UP's witnesses explain, once NAFTA Rail headquarters in Kansas City, Missouri, gains control of both Tex Mex and TFM., it will have incentives and opportunities to disrupt other U.S. railroads' ability to compete for cross-border traffic and thus reduce competition for that traffic within the United States. U.S. shippers will face higher rates and lower service quality, because most of them have no efficient alternative to rail service over the Laredo Gateway.

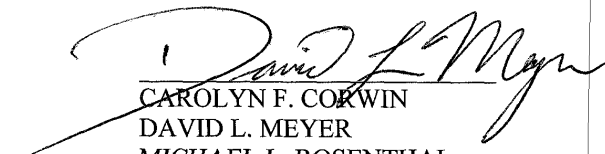
Applicants have recognized the anticompetitive potential of their transaction. They offer three commitments designed to forestall concerns. They also offer to negotiate agreements to implement their commitments. UP believes that these commitments, if made concrete and specific through negotiated agreements, would adequately address the competitive problems this transaction presents. The conditions would not grant UP special benefits or interfere with Applicants' efforts to obtain whatever efficiencies they can from their transaction. They are fully in accord with the Board's policies of preserving major gateways and holding applicants to their on-the-record representations in control cases.

UP's request for conditions is straightforward: The Board should require Applicants to abide by their commitments, including their promises to negotiate agreements that implement these commitments. Only the Board can make those commitments

enforceable. The Board should direct the Applicants to negotiate appropriate agreements. If those negotiations are not successful, the Board must be prepared to impose reasonable terms that make Applicants' commitments meaningful and enforceable.

Respectfully submitted,

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August 4, 2003

CERTIFICATE OF SERVICE

I, Michael L. Rosenthal, hereby certify that on this 4th day of August, 2003,

I caused a copy of Union Pacific's Comments to be served by hand on:

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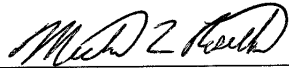
and by overnight mail on:

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I further certify that I caused a copy of the Public Version of Union Pacific's
Comments to be served by overnight mail on:

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and by first-class mail, postage prepaid, or by a more expeditious manner of delivery on all
other parties of record in Finance Docket No. 34342.



Michael L. Rosenthal

Exhibits

TABLE OF EXHIBITS

Exhibit 1	Excerpts from the Brief of the Texas Mexican Railway Company in <i>UP/SP</i> proceeding (TM-39) (June 3, 1996)
Exhibit 2	Letter from William A. Mullins to David L. Meyer, July 21, 2003 (filed with Board and served on all parties of record) ("Applicants' July 21 Letter")
Exhibit 3	Grupo TMM Press Release, April 21, 2003.
Exhibit 4	{{ }}
Exhibit 5	{{ }}
Exhibit 6	KCS PowerPoint Presentation: Nafta Rail Transaction Summary
Exhibit 7	KCS 3rd Quarter Presentation Slide
Exhibit 8	Agreement between the National Industrial Transportation League and Canadian League and the Canadian National Railway Co., Apr. 27, 2001
Exhibit 9	Excerpts from the Responsive Application of the Texas Mexican Railway Company in <i>UP/SP</i> proceeding (TM-23) (March 29, 1996)
Exhibit 10	Excerpts from <i>Western Coal Traffic League v. STB</i> , No. 96-1373, Brief of Respondent STB (Dec. 1997)
Exhibit 11	Transcript of KCS Presentation to Analysts, April 29, 2003
Exhibit 12	Excerpts from KCS NEWS
Exhibit 13	Submissions from Shippers Requesting Conditions
Exhibit 14	Excerpt from the DOJ/FTC 1992 Horizontal Merger Guidelines
Exhibit 15	KCS/Tex Mex Responses to Interrogatories 3, 5, and 7 (KCS-14)
Exhibit 16	Excerpt from the Texas Mexican Railway Company's Petition to Reopen Decision No. 44 in the <i>UP/SP</i> proceeding (TM-44) (Sept. 3, 1996)

- Exhibit 17 *UP/SP*, Rebuttal in Support of the Responsive Application of the Texas Mexican Railway Company (TM-34), Verified Statement of Joseph Ellebracht (May 14, 1996)
- Exhibit 18 *UP/SP*, Comments of the Kansas City Southern and Request for Conditions, Volume I (KCS-33) (March 29, 1996), Verified Statement of Curtis Grimm
- Exhibit 19 Union Pacific's Condition Proposals
- Exhibit 20 Union Pacific's Opening Comments on Proposed Merger Rules in STB Ex Parte No. 582 (Sub-No.1), Major Rail Consolidation Procedures
- Exhibit 21 Letter from David L. Meyer to William A. Mullins, July 30, 2003

REDACTED - To be filed on the public record

TM-39

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

UNION PACIFIC CORP., UNION PACIFIC RR. CO. AND
MISSOURI PACIFIC RR CO.
-- CONTROL AND MERGER --
SOUTHERN PACIFIC RAIL CORP., SOUTHERN PACIFIC
TRANS. CO., ST. LOUIS SOUTHWESTERN RW. CO.,
SPCSL CORP. AND THE DENVER AND RIO GRANDE WESTERN CORP.

Finance Docket No. 32760, Sub No. 13

THE TEXAS MEXICAN RAILWAY CO.
-- TRACKAGE RIGHTS OVER LINES OF
THE UNION PACIFIC RR. CO. AND SOUTHERN PACIFIC TRANS. CO.

Finance Docket No. 32760, Sub No. 14

THE TEXAS MEXICAN RAILWAY COMPANY
-- TERMINAL TRACKAGE RIGHTS OVER LINES OF
THE HOUSTON BELT & TERMINAL RAILWAY CO.

BRIEF OF
THE TEXAS MEXICAN RAILWAY COMPANY

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June 3, 1996

BEFORE THE
SURFACE TRANSPORTATION BOARD

Union Pacific Corp., Union Pacific) RR. Co. and Missouri Pacific RR Co.) -- Control and Merger -- Southern) Pacific Rail Corp., Southern) Pacific Trans. Co., St. Louis) Southwestern R.W. Co., SPCSL Corp.) and The Denver and Rio Grande) Western Corp.)	Finance Docket No. 32760
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BRIEF OF THE TEXAS MEXICAN RAILWAY COMPANY

INTRODUCTION AND SUMMARY

The Texas Mexican Railway ("Tex Mex"), chartered in 1875, is one of the oldest railroad companies in the United States. It owns and operates 157 miles of railroad between Corpus Christi, Texas on the Gulf of Mexico and Laredo, Texas on the Rio Grande. Tex Mex and UP are the two U.S. railroads serving Laredo. Laredo is the main rail gateway between the United States and Mexico; in 1994 Laredo handled 55% of the total tonnage moving by rail between the two countries.

Tex Mex connects with SP at Corpus Christi. Tex Mex and SP together provide the only competition to UP for traffic moving through Laredo. Although UP carries most of that traffic, the competition from Tex Mex and SP has been very effective in keeping UP's rates and service reasonable.

Industries, Inc. ("KCSI"), which controls KCS, to bid on rail lines or concessions (e.g., trackage rights) in Mexico that will be sold later this year as part of the privatization of Mexico's rail system, and to operate any lines or concessions acquired. In November, 1995 KCSI also purchased 49 percent of the stock of Mexrail from TMM.

2. Laredo and the Other U.S.-Mexican Rail Gateways

As noted, Tex Mex serves Laredo, where it interchanges traffic with FNM. The only other U.S. railroad serving Laredo is UP, which serves it via a line running south from San Antonio.

Laredo is the principal rail gateway between the United States and Mexico. In 1994, 55 percent of the total tonnage moving by rail through the eight U.S.-Mexico gateways moved through Laredo.^{4/} This fact is due to its superior infrastructure and its location on the shortest route between many U.S. and Mexican origins and destinations. TM-34, Ellebracht RVS at 5.

Significant volumes of grain and other agricultural products, minerals, woodpulp, paper products, automobiles and automobile parts, and other metals flow through the Laredo gateway. Ellebracht VS, TM-23 at 91. Much of this is bulk traffic that moves long distances and for which truck transport is not a viable alternative. Id. at 92.

^{4/} The other seven gateways are: Calexico, Naco, Nogales, El Paso, Presidio, Eagle Pass and Brownsville.

Although UP traditionally has handled most of the freight that moves over the Laredo gateway, the SP-Tex Mex route has accounted for a substantial amount of that traffic and offers "customers an alternative . . . of significant value." Id. at 67-68. In fact, for shipments originating on other railroads not including UP, the SP-Tex Mex route has been the overwhelming choice of those railroads and shippers for traffic moving to Laredo. Id. at 66. As we discuss more fully in the Argument, the Tex Mex-SP route has provided the only competition to UP for traffic through the Laredo gateway and the principal competition for UP for U.S.-Mexican traffic in general.

Although Laredo is the preferred rail gateway to Mexico and has a number of advantages, other gateways also handle a substantial amount of U.S.-Mexican rail traffic, and, as we will discuss further in the Argument, serve as alternative routes for many movements. The significant gateways for rail traffic to and from the industrial centers of Mexico are, in order of volume, Laredo, El Paso, Brownsville and Eagle Pass.^{5/} UP currently serves Laredo, El Paso and Brownsville. SP serves Laredo (with Tex Mex), El Paso and Eagle Pass. BNSF serves El Paso; since the

^{5/} Presidio, the fifth Texas gateway, is served by BNSF and the South Orient Railroad.

The three non-Texas gateways are all served by SP and will be served by UPSP following the merger. The BNSF Settlement does not grant BNSF access to any non-Texas gateways.

BNSF merger, it also serves Eagle Pass via haulage rights over SP's line and will obtain trackage rights to Eagle Pass and Brownsville under the BNSF settlement. In 1994, UP and SP together accounted for percent of the rail tonnage between the U.S. and Mexico via all gateways. Ellebracht VS, TM-23 at 77, as corrected by TM-28, errata filed April 12, 1996.^{6/}

ARGUMENT

I. TEX MEX IS A VITAL LINK IN MAINTAINING COMPETITIVE RAIL SERVICE BETWEEN THE UNITED STATES AND MEXICO.

As noted in the Statement of facts, the SP-Tex Mex route provides the only competition today to UP for rail traffic moving between the United States and Mexico via Laredo and provides the principal competition to UP for U.S.-Mexican traffic moving via all gateways. That competition is substantial and extremely important in keeping the rates for that traffic down and the quality of service up.

As Mr. Ellebracht discusses, although UP has carried most of the freight over the Laredo gateway, for traffic where the shipper at origin has a choice of routings "the SP-Tex Mex route has a respectable market share." Ellebracht VS, TM-23 at 67. Indeed, his analysis of traffic data shows that "neutral origins

^{6/} This percentage figure includes traffic that SP moved to and from Mexico with Tex Mex but does not include traffic that Tex Mex moved to and from Mexico without SP -- i.e., Mexican traffic to or from Tex Mex's local customers, like Corpus Christi Grain Company. This "Tex Mex-only" traffic accounted for percent of the total U.S.-Mexican rail tonnage in 1994 and percent of the U.S.-Mexican rail tonnage moving through Laredo.

Settlement as a competitive remedy reflects Applicants' recognition of that fact. Although the Mexican rail system is currently state owned, Mr. Ellebracht explains that, for many reasons, rates for the Mexican portion of international moves are, in the vast majority of cases, established without regard to the rates established for the U.S. portion of the moves. Rates for most Mexican moves are established according to a distance-based formula, and through international rates are rare. Ellebracht VS, TM-23 at 78-79. Accordingly, he concludes, "the vigorous competition that now exists between U.S. railroads for that traffic directly benefits the shippers, and any reduction in that competition will harm them." Id. at 79. Applicants have not disputed this.

In this regard, it is also important to stress that ensuring the most vigorous competition for the transportation of goods between the United States and Mexico is clearly consistent with the national policies of both nations as reflected in the North American Free Trade Agreement ("NAFTA"). The central purpose of NAFTA is to promote trade between the two countries. Strong competition among transportation providers is a tremendous stimulus to trade, just as lack of competition suppresses it.^{8/}

^{8/} A number of the statements and letters submitted in support of Tex Mex's responsive application have noted that NAFTA provides a great potential for expanding their businesses which they believe would be seriously threatened by the reduction in the number of railroads serving the U.S.-Mexico market. See, e.g., Feldman VS at 1, TM-23 Ex. 24.

For that reason, NAFTA contains provisions specifically designed to increase competition in cross border transportation services.^{9/} As former Secretary of Transportation Andrew Card stated, the purpose of these provisions is to "ensure that the increased trade resulting from the agreement can be carried across the border efficiently and competitively."^{10/} The same policy, Tex Mex submits, requires this Board to give heightened scrutiny to transactions within its jurisdiction that present a danger of diminishing competition for transportation of U.S.-Mexican traffic. Cf. McAllen, TX Commercial Zone -- Passenger Operations, Ex Parte No. MC-37 (Sub No. 43) (served Oct. 24, 1995) (ICC should exercise its discretion consistently with the policies of NAFTA).^{11/}

^{9/} Section 1202 of NAFTA and Annex II- Mexico. While most of these pertain to motor carriers, according to the Department of Transportation NAFTA also "opens the Mexican market for U.S. railroads and intermodal companies" and

"affirms the market-oriented reforms already undertaken by the Mexican government which allow U.S. railroads and intermodal companies to:

- Market their services directly to customers;
- Carry cargoes directly to Mexican destinations using their own equipment;
- Own and operate terminals and other facilities; and
- Finance the building of tracks and other rail infrastructure."

DOT News Release 71-92, "Transportation Facts," p. 2 (August 12, 1992).

^{10/} Remarks of Secretary Card as reported in DOT Release 71-92, issued August 12, 1992.

^{11/} As we discuss in Part V, below, granting the rights sought by Tex Mex will provide a strong competitive alternative to a merged UPSP and to BNSF for U.S.-Mexican traffic by linking Tex Mex with the KCS system and with KCS's eastern railroad

\$19.92 million in the absence of the UP/SP merger. With the UP/SP merger and the BNSF Settlement, he concludes that Tex Mex's revenues would be \$13.24 million, or 34 percent less. Ellebracht VS, TM-23 at 98-106.

Based on Mr. Ellebracht's traffic and revenue projections, Tex Mex witness Patrick Krick conducted a financial analysis of the impact of the merger, both as conditioned by the BNSF Settlement and as conditioned by the BNSF Settlement and the rights Tex Mex requests, on Tex Mex's net income. Mr. Krick's analysis shows that a post-merger Tex Mex would immediately go from profitability to unacceptably heavy losses, and he quite simply concludes that Tex Mex "would not survive the UP/SP merger if it is not conditioned by the rights [Tex Mex] requests in its responsive application." Krick VS, TM-23 at 190. On the other hand, Mr. Krick concludes that if Tex Mex is granted the trackage rights it seeks, Tex Mex would remain a viable railroad. Id. at 193.

If Tex Mex did not survive, many of its shippers would lose essential rail service for which they have no feasible transportation alternatives. As described in the Statement of Facts, Tex Mex local shippers like Barr Iron and Metal Co., Corpus Christi Grain Co., and Global Grain Co. have shown that they depend on Tex Mex to transport their products to their markets and that neither trucks nor other railroads are practical alternatives. For example, to ship grain from Corpus Christi to Mexico City or other points in central Mexico, trucks are

obviously not feasible and any rail routing other than Tex Mex would have to go through San Antonio, at least doubling the distance to Laredo and drastically increasing the costs. Furthermore, UP and SP have shown no interest in providing reasonable or reliable service to those shippers. See statements of William E. Bailey and Abel Gonzalez, Jr., TM-23, Ex. 24.

Applicants' chief response to Tex Mex's "loss of essential services" showing is to dispute Mr. Ellebracht's diversion study and claim that Tex Mex will be healthier, rather than gravely damaged, by the merger and Applicants' settlement with BNSF. Applicants do not address or refute Mr. Krick's showing that Tex Mex cannot sustain operations with the loss of traffic that Mr. Ellebracht projects that the merger will cause to Tex Mex.

The criticisms of Mr. Ellebracht's traffic study by Applicants' traffic witness, Richard Peterson, are completely unfounded. First, as Mr. Ellebracht shows in his rebuttal statement, Mr. Peterson's very rosy forecasts about the additional traffic BNSF will supposedly bring to Tex Mex at Robstown are highly improbable on their face. Since Tex Mex already gets 73% of the traffic originated by BNSF destined for Laredo and 99% of the Laredo-bound traffic originated by SP, even if BNSF post merger funneled all of its remaining traffic to Tex Mex, that would not nearly make up for the SP traffic Tex Mex is almost certain to lose. TM-34, Ellebracht RVS at 26-27. Furthermore, it is highly unlikely that BNSF will funnel all of its remaining traffic to Tex Mex after the merger. Indeed, since

the BNSF Settlement will give BNSF trackage rights to Eagle Pass in place of BNSF's current haulage rights and since Eagle Pass is a shorter route for many BNSF moves from western origins than a BN-Tex Mex-Laredo route, it is quite likely that Tex Mex will lose much of the traffic it could expect to receive from BNSF origins in the absence of the merger. Id. at 27.

Mr. Peterson also disparages some of the adjustments Mr. Ellebracht made to Tex Mex's 1994 traffic based on the BNSF merger and other developments since 1994 as "inventing" traffic. Such adjustments, however, are inherent in the methodology used by both Mr. Peterson and Mr. Ellebracht and are common in traffic studies. Mr. Ellebracht's adjustments are no more "invention" than the many adjustments Mr. Peterson made in his traffic study, such as his projections of additional traffic for UP and SP as a result of the UP/CNW and BNSF mergers. Furthermore, Mr. Ellebracht explains in detail why the assailed adjustments are "well founded and entirely reasonable." Id. at 28-29.

In contrast, some of the major assumptions Mr. Peterson made about Tex Mex's post merger traffic are patently unrealistic. Of particular note is Mr. Peterson's assumption that half of the traffic from SP origins that are now routed SP-Tex Mex will continue to be routed to Tex Mex after the merger. This is fanciful. As Mr. Ellebracht noted in his verified statement: "Today there is a tiny trickle of UP-Tex Mex traffic through Robstown to Laredo for which there is a competing UP direct route through San Antonio to Laredo." Ellebracht VS, TM-23 at 105-106.

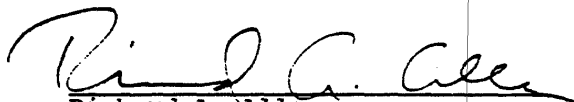
possible, and transportation between the United States and Mexico would be dominated entirely by a merged UPSP.

The trackage rights sought by Tex Mex will also ensure that Tex Mex and its shippers will not be completely dependent on a connection with BNSF which, for the reasons discussed, is extremely doubtful. As shown by Mr. Ellebracht and Mr. Krick, these rights are likely to generate sufficient traffic and revenues to permit Tex Mex to remain viable and thus to continue providing essential rail services to its shippers.

CONCLUSION

The Board should grant the responsive application and the application for terminal trackage rights of the Texas Mexican Railway Company in this proceeding.

Respectfully submitted,



Richard A. Allen
Andrew R. Plump
John V. Edwards
ZUCKERT, SCOUTT & RASENBERGER, LLP
888 Seventeenth Street, NW
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202/298-8660

Attorneys for Texas Mexican Railway
Company

Dated: June 3, 1996

BAKER & MILLER PLLC

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July 21, 2003

BY HAND DELIVERY

David L. Meyer, Esq.
Covington & Burling
1201 Pennsylvania Avenue, N.W.
Washington, DC 20004-2401

RE: Your Letter of June 30 Regarding Kansas City Southern's Application
For Authority to Control The Texas Mexican Railway Company,
STB Finance Docket No. 34342

Dear David:

As you know, Kansas City Southern ("KCS") and Union Pacific Railroad Company ("UP") are currently in private discussions regarding UP's concerns over KCS's plans to acquire control of The Texas Mexican Railway Company ("Tex Mex") and TFM, S.A. de C.V. ("TFM"), along with other commercial issues impacting the two companies. You also know that KCS and UP have a confidentiality agreement governing those discussions. Given that background, your July 16 letter asking KCS to respond to your June 30th letter, both of which you served on all parties of record, seems more of an effort by UP to gain some sort of perceived leverage in those negotiations rather than an honest attempt to resolve UP's concerns over the two transactions. Bringing these issues into the public arena, while at the same time negotiating in private, leads one to question UP's motives and its willingness to truly negotiate in good faith.

KCS realizes that there may be other parties, in particular shippers and shipper associations, who would like some clarification of KCS's commitments made in the Application and the Supplement. KCS is talking to these parties. If it is true as you state in your letter that there are other parties unbeknownst to KCS who share UP's concerns, KCS, as always, remains willing to discuss those concerns with these parties in private. Nonetheless, if there are parties who need further clarification on the public record, KCS offers the following:

Laredo Bridge

KCS of course expects that Tex Mex and TFM will continue to cooperate with UP regarding the utilization of the International Bridge across the Rio Grande River at Laredo. As you know, operations over the International Bridge are governed by a series of

Mr. David L. Meyer, Esq.
July 21, 2003
Page 2

agreements dating back to 1951. KCS will honor all existing agreements governing operations over the bridge. In addition, KCS is willing to work cooperatively with UP toward efficient utilization of the bridge and will work in good faith with UP to develop dispatching protocols acceptable to both parties. KCS is confident that it can reach agreement with UP over such dispatching protocols as part of its private discussions with UP. Nonetheless, KCS would be willing to make its commitment to negotiate in good faith new dispatching protocols a condition of its common control of Tex Mex.

Working With UP and BNSF

As KCS has said publicly on many occasions, regardless of whether KCS obtains additional ownership in TFM, it will continue to be in TFM's best interest to work cooperatively with UP and BNSF. KCS remains committed to seeing that UP and BNSF are provided the same level of service they have experienced in the past, and to making improvements on that level of service where possible. KCS further commits that it will use its control of TFM (assuming this transaction is consummated) to require TFM to cooperate with both UP and BNSF on pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars for shipments, accommodating run-through train service, providing excellent service, and promptly quoting rates. KCS is also willing to work with UP and BNSF on development of a methodology for measuring service standards and to develop a method by which such standards could be enforced.

Keeping the Laredo Gateway Open

KCS believes that all affected parties are interested in keeping the Laredo Gateway open on commercially reasonable terms. KCS is willing to enter into private discussions with UP or any other party to discuss this commitment and reach a private agreement to ensure that KCS abides by this commitment.

Existing Tex Mex and TFM Agreements

In conjunction with this commitment, KCS will abide by all existing agreements between TFM and Tex Mex and any other carrier, including any agreements providing for rates and divisions at the Laredo gateway, until the termination date set forth in those agreements. KCS, however, is not willing to simply renew or indefinitely extend all agreements under the old terms without undertaking a good faith negotiation. KCS would not expect UP and BNSF to do so either, and does not believe that either did so in their most recent mergers. KCS is not willing to agree to an anticompetitive "freezing" of existing rates or divisions.

General Issues

Depending on the exact form any final agreement would take with respect to settlement of the foregoing issues, KCS expects to be able to agree to the imposition of its commitments on the Laredo Bridge and on working with UP and BNSF (particularly on operational monitoring) as conditions upon the STB's order approving the KCS-Tex Mex

Mr. David L. Meyer, Esq.
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Page 3

transaction. However, because the Board has no jurisdiction to impose conditions on TFM, any agreements relating to TFM would have to remain a matter of contract between the parties.

UP's Commitments Regarding the Trackage Rights Lines

As you know, over the past three years, UP and Tex Mex officers have been discussing the congestion problems on UP's lines over which Tex Mex operates under trackage rights, and when UP was going to take promised steps to alleviate those problems. UP made commitments in its 1998 Infrastructure Plan, as well as contractual commitments, to maintain adequate infrastructure to prevent deterioration of service over the trackage rights lines. KCS and others do not believe UP has lived up to these commitments. So in response to your questions, KCS asks when UP is going to meet the contractual and public commitments regarding maintaining the infrastructure and transit times on the UP lines used by Tex Mex, particularly the Brownsville Subdivision?

Sincerely,



William A. Mullins

cc: The Honorable Vernon A. Williams
All Parties of Record



Date: April 21, 2003

Media Contact: William H. Galligan, 816-983-1551 or william.h.galligan@kcsr.com

**KCS and TMM Announce Agreements
Placing TFM, Texas Mexican Railway and
The Kansas City Southern Railway Under Common Control**

Kansas City Southern (KCS) (NYSE: KSU) and Grupo TMM, S.A. (Grupo TMM) (NYSE: TMM) today announced a series of agreements that have been approved by their respective boards of directors, that will, following shareholder and regulatory approval, place The Kansas City Southern Railway Company (KCSR), the Texas Mexican Railway Company (Tex-Mex), and TFM, S.A., de C.V. (TFM) under the common control of a single transportation holding company, NAFTA Rail, to be headquartered in Kansas City, Missouri. As part of the transaction, KCS will change its name to NAFTA Rail, which will trade on the New York Stock Exchange (NYSE).

The common control of The Kansas City Southern Railway Company and the Texas Mexican Railway under NAFTA Rail, would require approval of the Surface Transportation Board in the United States. Additionally, the acquisition of Grupo TFM shares by NAFTA Rail would require the approval of the Competition Commission and the Foreign Investment Commission in Mexico.

"Common control of these three railroads, which are already physically linked in an end-to-end configuration, will enhance competition and give shippers in the NAFTA trade corridor a strong transportation alternative as they make their decisions to move goods between the United States, Mexico and Canada," said Michael R. Haverty, chairman, president, and chief executive officer of KCS. "KCS already owns KCSR and has significant investments in Tex-Mex and TFM, so these agreements are just a natural business progression offering KCS and Grupo TMM shareholders greater value through the operating efficiencies that will come from common ownership and control."

Jose Serrano, chairman and chief executive officer of Grupo TMM, said, "These transactions will be pro-competitive and allow Mexico to strengthen its position in the North American economy. NAFTA Rail will provide a viable rail alternative, while still preserving existing competitive gateways at the border between Mexico and the United States."

"I am very pleased that we have been able to complete these agreements and that they have been approved by the boards of both companies. We believe that the shareholders of both companies will benefit from bringing these three companies under common ownership," said Serrano. "Both NAFTA Rail and Grupo TMM will continue to work closely together in the future and have agreed to enter into a marketing agreement to further our shared goals of providing end-to-end transportation for our customers."

Mr. Haverty will serve as chairman, president, and chief executive officer of NAFTA Rail. Mr. Serrano will serve as vice chairman of NAFTA Rail and chairman of TFM, while also joining the NAFTA Rail

-more-

Press Release
April 21, 2003

board of directors along with Javier Segovia, president of Grupo TMM. The remainder of the 10-person board will be made up of existing KCS directors. Mario Mohar will remain as chief executive officer of TFM.

Under the Grupo TFM acquisition agreement, TMM Multimodal, a subsidiary of Grupo TMM, will receive 18 million shares of NAFTA Rail representing approximately 22 percent (20% voting, 2% subject to voting restrictions) of the company, \$200 million in cash and a potential incentive payment of between \$100 million and \$180 million based on the resolution of certain future contingencies.

Grupo TFM owns 80 percent of the common stock of TFM and all the shares entitled to full voting rights. The Mexican Government owns the remaining 20% of TFM. TFM holds the concession to operate Mexico's Northeast Rail Lines for 50 years ending June 2047, and has the option to extend the concession for an additional 50 years. The TFM rail network consists of more than 2,600 miles of main track.

KCSR will remain headquartered in Kansas City, Missouri; Tex-Mex in Laredo, Texas; and TFM in Mexico City.

KCS is a transportation holding company that has railroad investments in the United States, Mexico, and Panama. Its primary holding is The Kansas City Southern Railway Company. Headquartered in Kansas City, Missouri, KCS serves customers in the central and south central regions of the U.S. KCS's rail holdings and investments are primary components of a NAFTA Railway system that links the commercial and industrial centers of the United States, Canada, and Mexico.

Headquartered in Mexico City, Grupo TMM is the premier Mexican multimodal transportation company and logistics provider. Through its branch offices and network of subsidiary companies, Grupo TMM provides a dynamic combination of ocean and land transportation services within Mexico. Grupo TMM also has the controlling interest in TFM, which operates Mexico's Northeast Rail Lines and carries over 40 percent of the country's rail cargo.

In connection with the proposed transaction, Kansas City Southern will file relevant materials with the Securities and Exchange Commission ("SEC"), including a proxy statement soliciting shareholder approval of the transaction. Shareholders are urged to read the proxy statement, as well as any amendments and supplements to the proxy statement (if and when they become available) and any other relevant documents filed with the SEC, because they will contain important information about the transaction. Shareholders may obtain the proxy statement and any other relevant documents free of charge at the SEC's Internet web site at www.sec.gov. The proxy statement and any other relevant documents may also be obtained free of charge by contacting the office of the Corporate Secretary at Kansas City Southern's principal executive offices at (816) 983-1538. Written requests should be mailed to P.O. Box 219335, Kansas City, Missouri 64121-9335 (or if by federal express or other form of express delivery to 427 West 12th Street, Kansas City, Missouri 64105).

Media/Analysts Conference Call Notice:

There will be a 10:00 A.M. Central Daylight Time (11:00 A.M. Eastern Daylight Time) conference call today, April 21st, discussing the proposed common control agreement hosted by Michael Haverly, Jose Serrano, and Ronald Russ, KCS executive vice president and chief financial officer. The call will be to discuss the NAFTA Rail transaction. Questions relating to TMM and its financial statement will be handled separately by TMM. A discussion of the transaction is available at the KCS website at www.kcsi.com. Those interested in participating are invited to call 1-800/955-1795 (U.S. and Canada) or 1-706/643-0096 or 001-800-514-7616 (International).

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Participants should call at least five minutes before the conference call begins. A replay of the discussion will be available for one week after the conference call. Replay numbers are 1-800/642-1687 (U.S. & Canada) or 1-706/645-9291 (International).

Included in this press release are certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements are based on the beliefs of the Companies' managements as well as on assumptions made. Actual results could differ materially from those included in such forward-looking statements. Readers are cautioned that all forward-looking statements involve risks and uncertainty. The following factors could cause actual results to differ materially from such forward-looking statements: global, US and Mexican economic and social conditions; the effect of the North American Free Trade Agreement on the level of US-Mexico trade; the condition of the world shipping market; the success of the Companies' investment in TFM, S.A. de C.V. and other new business risks. These risk factors and additional information are included in Grupo TMM's and KCS' reports on file with the Securities and Exchange Commission.

EXHIBIT FILED UNDER SEAL

EXHIBIT FILED UNDER SEAL

**NAFTA
Rail**

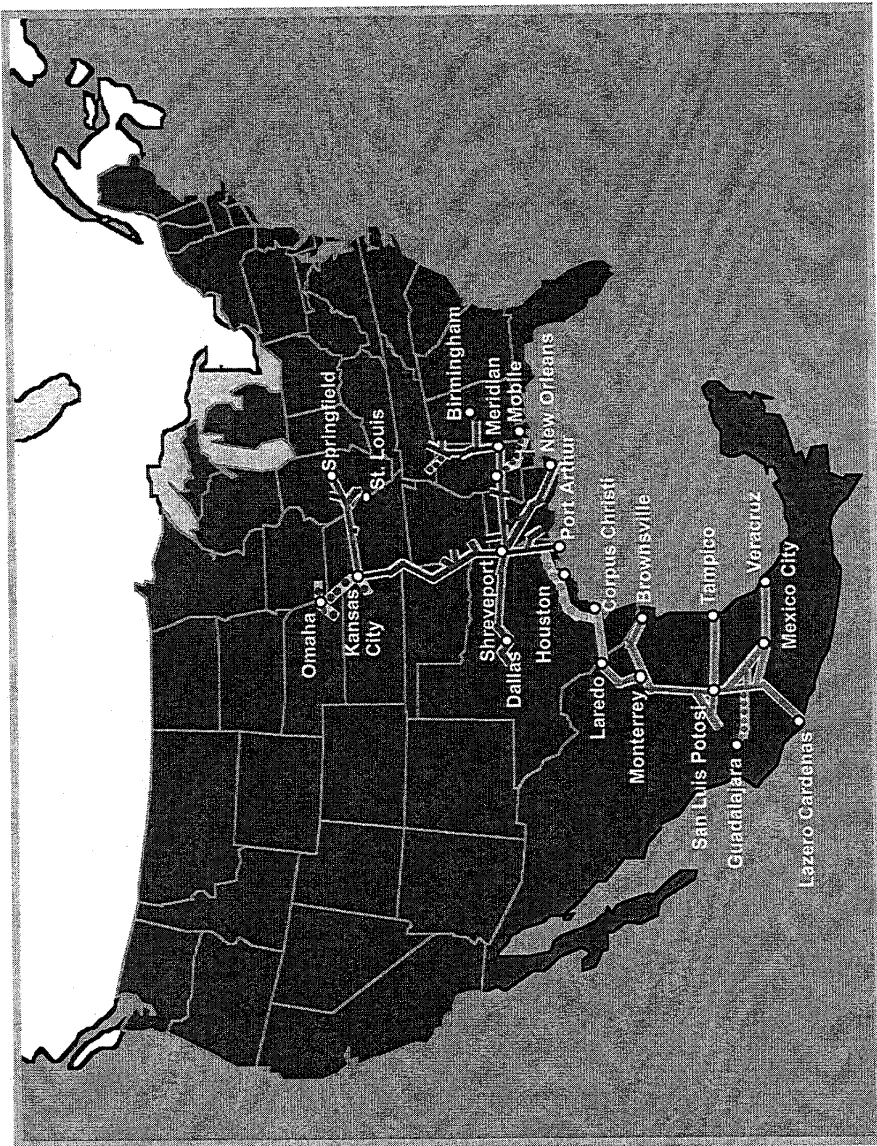


transaction summary

NAFTA
Rail

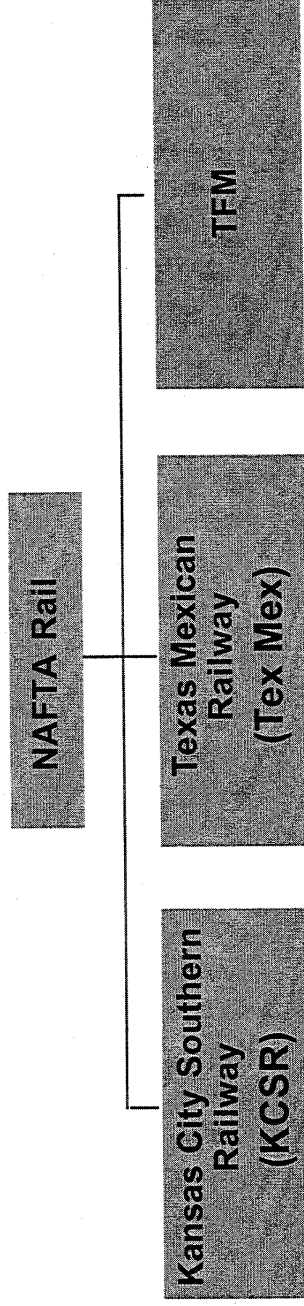


KCSR, Tex Mex, TFM Operating Under Common Control



NAFTA Rail

Common Control



- NAFTA Rail will be a U.S. corporation, headquartered in Kansas City, with three separate railroad companies that connect end to end and operate under integrated management
 - KCS and Tex Mex are U.S. corporations
 - TFM is a Mexican corporation
- Surface Transportation Board approval of the common control of KCSR and Tex Mex is required
- Mexico's Foreign Investment Commission will review the foreign control of TFM
- Mexico's Competition Commission will review the transaction for competitive effects

Strategic Rationale for NAFTA Rail

- Enhance shareholder value by achieving consolidation of rapidly expanding TFM affiliate in Mexico, with U.S. ownership
- Accretive from day one
- Improve Tex Mex infrastructure and operations to better link the Kansas City Southern Railway with TFM
- Strengthen KCSR/Tex Mex/TFM as the "NAFTA Railroad" in North America
- Increase EPS contribution from faster-growing rail operations in Mexico
- Lengthen hauls through an "across-the-border" view



Enhanced Competition

- **Three railroad companies connecting end to end to end**
 - Maintain the unique culture of each company
 - Operating under integrated management
 - Only *enhances* competition—no reduction of competitors in any market
 - No “2 to 1 points”
 - No overlaps
- **Common operating platform, MCS: planned implementation on Tex Mex in September 2003, and on TFM in Q1 2004**
 - MCS now operating smoothly at KCSR
 - Common customer access
 - Pro-active service management
- **Tightly managed service across U.S.-Mexico border**
- **Seamless service**
 - Southern Mexico to the heart of the U.S.
 - Integrated operating system
 - Integrated customer service



- Combined resources lead to enhanced product offerings
 - 965 locomotives
 - 25,206 freight cars
 - 140 transload/reload locations
 - 14 intermodal ramps
 - 13 ports
 - 181 interchange points with other railroads



NAFTA RAIL Governance and Management

- **Board of Directors, initially ten members:**
 - Mike Haverty, Chairman
 - Pepe Serrano, Vice-Chairman
 - Seven (in addition to Mike Haverty) current KCS Board members; plus Javier Segovia, President of TMM
- **Management of NAFTA RAIL**
 - Chairman, President & CEO: Mike Haverty
- **Management of Kansas City Southern Railway**
 - Chairman, President & CEO: Mike Haverty
- **Management of TFM**
 - Chairman: Pepe Serrano
 - CEO: Mario Mohar



Transaction Summary

- **To NAFTA RAIL from GTMM**

- 38.8% of effective ownership of TFM

- **To GTMM from NAFTA RAIL**

- 18 million shares of NAFTA RAIL
- \$200 million cash
- Potential incentive payment of \$100 million-\$180 million based on a resolution of certain contingencies

- **51.0% of Mexrail acquired by NAFTA RAIL for \$32 million**



Financial Summary

Income statement data *

(US\$mm)

	KCS consolidated	Grupo TFM consolidated	combined
2002 Revenue	\$ 566	\$ 712	\$ 1,278
growth vs. '01	(1.9 %)	6.6%	2.7%
2002 EBITDA	\$ 109	\$ 259	\$ 368
margin	19.3%	36.4%	28.8%
2002 EBIT	\$ 48	\$ 176	\$ 224
margin	8.5%	24.7%	17.5%

* NOTES:

KCS consolidated 2002 EDITDA and EBIT exclude KCS' equity in earnings of Grupo TFM, resulting from existing 37.3% of effective ownership in TFM.

Combined amounts are presented only to demonstrate the relative size of NAFTA Rail if the transaction is consummated. The combined amounts do not reflect the impacts of the application of purchase accounting and do not purport to reflect *pro forma* financial results as if the transaction had been consummated at the beginning of 2002.



Financial Summary (continued)

Balance Sheet data *
(US\$mm)

	KCS consolidated	Grupo TFM consolidated	combined
Cash	\$ 19	\$ 30	\$ 49
Debt	\$ 583	\$ 1,023	\$ 1,606
Net debt	\$ 564	\$ 992	\$ 1,556

* NOTES:

Balance sheet data before acquisition financing. Source: Balance sheet data as of 12/31/02.
Combined amounts are presented only to demonstrate the relative size of NAFTA Rail if the transaction is consummated. The amounts do not reflect the impacts of the application of purchase accounting and do not purport to reflect *pro forma* balance sheet data as if the transaction had been consummated at December 31, 2002.



Value Added Tax (VAT) Update

- TFM filed a lawsuit against the Mexican Government in 1997 alleging that the Government failed to make a value added tax refund in the amount of \$206 million
- October 11, 2002: the Mexican Magistrates Court (the appellate court) unanimously ruled in favor of TFM and ordered the lower Fiscal Court to issue a new ruling consistent with the appellate court's opinion
- December 10, 2002: the lower Fiscal Court issued a ruling denying TFM the right to receive the VAT refund
- TFM appealed the December 10th ruling to the Mexican Magistrates Court on January 29, 2003





Purchase Price Summary

No VAT/ No Put

18.0M shares issued @ \$11.77 (closing 4/17/03)

Cash

Purchase total

Total value for TMM's interest

TMM's interest in TFM

Implied equity value of TFM

TFM debt

TFM cash

Implied Total Enterprise Value

\$ 211.9
\$ 200.0
\$ 411.9

\$ 411.9
38.8%

\$ 1,061.5
\$ 1,023.1
\$ 30.2
\$ 2,054.4

Implied multiples:

TFM metrics

2002 revenue

2002 EBITDA

2002 EBIT

\$ 712.1

\$ 259.2

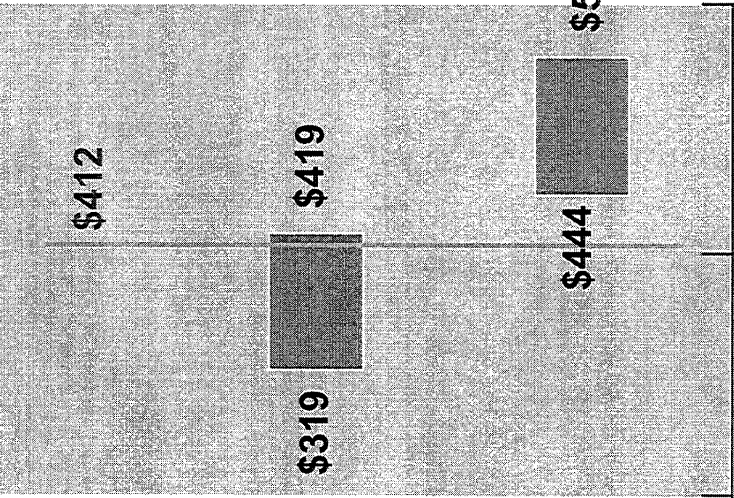
\$ 176.1

2.9x

7.9x

11.7x

Valuation Summary: 38.8% of GTFM

<u>Valuation Method</u>	<u>Valuation Range</u>	<u>Relevant Parameter</u>
Purchase Price		\$200 million plus 18 million shares @ \$11.77 per share
Rail Industry Trading Comparables		LTM EBITDA multiple: 7.0x – 8.0x
Rail Industry Transaction Comparables		LTM EBITDA multiple: 8.25x – 9.25x
	\$200 \$400 \$600	



Earnings Impact

No VAT/ No Put



	<u>2003E *</u>	<u>2004E *</u>
KCS standalone EPS	\$ 0.79	\$ 1.05
NAFTA Rail EPS	Higher	Higher
Benefit to NAFTA Rail shareholders	Accretive	Accretive

* First Call Estimates 4/17/03

NAFTA Rail

North American Rail Coverage with marketing alliances and connections



KCSI

Welcome to the Monday, October 26, 1998 Third Quarter Presentation. An audio replay of the presentation is available for the next several days at 888-203-1112 or 719-457-0820. Reference meeting #542111. Subsequently the replay will be available on this web site if there is interest.

Please **WAIT** now for all the slides to load before advancing to the next slide; your "browser" software (preferably Netscape ver 4+, but any browser will do) will indicate when it has finished loading. No special software is needed. Once all the slides have loaded, it is no longer necessary for you to maintain an internet connection to watch the slide program on most computers. You may disconnect. Disconnecting from the audio is not advised, as there is much wisdom here, not to be missed.

If your browser software has finished and all is well you can skip reading this long boring section and click "next" below to advance to the next slide. Reports on how long loading the slides takes vary from a couple of seconds on a very fast system (cable modem) to about 2-3 minutes on a typical 28.8 system and even 2X, 3X longer with a 14.4 modem on an older computer and/or a marginal quality phone-line connection. The worst-case we have observed in a properly operating but slow modem setup was about 10 minutes. If your browser is still actively loading much beyond that, you may want to reconsider. Please note that there are issues involved with choices of particular platforms/hardware/operating systems/browser software combinations that can make internet access speed problematical. There are bad modems and there are bad T1 implementations.

If you do not wait for the entire show to load now, you may encounter some "empty" slide frames as you advance through the program. You may be able to see these slides by clicking on the picture "icon" in the empty slide frame to load that individual slide. A "restart" option is available if all else fails. Depending on your installed software & settings, you may have to scroll to see the entire slide and the "next" prompt. Some very old software "browsers" will not scale the slides properly (the unscaled originals are very large).

Finally, these are screen images and will not print well.

next

Kansas City Southern Industries 10/26/98

Landon Rowland
KCSI Chairman, President & CEO

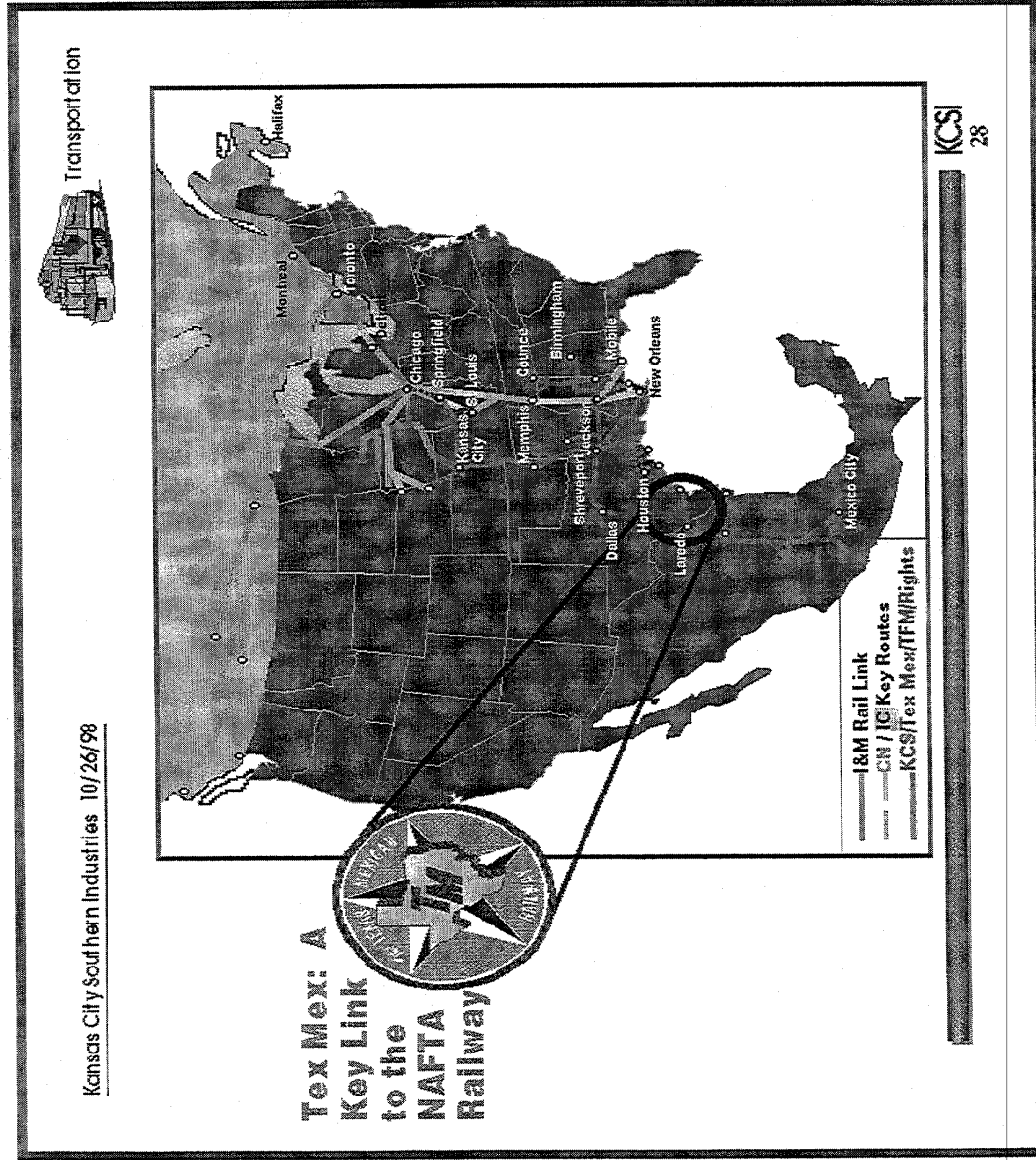
Mike Haverty
KCSR President & CEO

Joe Monello
KCSI Vice President & CFO

KCSI

2

next back [restart] -----Speaker: Landon Rowland, KCSI CEO



next back [restart] -----Speaker: Mike Haverly, KCSR CEO

Agreement between the National Industrial Transportation League
And
The Canadian National Railway Company

This Agreement is made this 27th day of April 2001 between The National Industrial Transportation League ("League"), and the Canadian National Railway Company and its affiliated rail carriers ("CN").

Whereas,

CN and Wisconsin Central Transportation Corporation ("WC") (together, "Rail Carriers"), have filed an Application before the Surface Transportation Board ("STB") seeking the STB's approval of the acquisition of control of WC by CN ("Transaction");

The League and CN desire to record the terms on which the League, having reviewed the Application, has agreed to support the Transaction and the treatment of the Transaction before the STB as a "minor transaction;" and

The League and CN desire to record the promises given by CN to the League for the benefit of the members of the shipping public in exchange for the League's support,

Now, therefore, in consideration of the mutual covenants contained herein, CN and the League agree as follows:

1) **League Support.** The League agrees to support STB approval of the Transaction. Within a reasonable time after the execution of this Agreement and no later than April 27, 2001, the League will submit a statement to the STB supporting the Transaction and the treatment by the STB of the Rail Carriers' Application for approval of the Transaction as one for approval of a "minor transaction" as that term is used in 49 C.F.R. §1180.2(c).

2) **Service Protection Agreements.** Upon the request of any shipper or receiver of property on CN and/or WC ("Shipper"), the Rail Carriers shall make a good faith offer to enter into an agreement with that Shipper with respect to that Shipper's traffic affected by the Transaction that, at a minimum:

a) Identifies that Shipper's base service level as the average transit time during each base period for each of the commodities shipped or received by that Shipper between each pertinent origin/destination pair affected by the Transaction. The base periods will be the twelve calendar months preceding the month in which the Transaction is consummated, or such other specific time periods agreed to by the Rail Carriers and that Shipper.

b) Assures that average transit-time at the base service level will not be adversely affected by the Transaction.

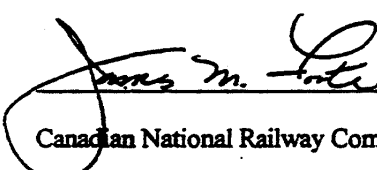
- c) Provides for (i) Shipper notice to CN if that Shipper's average transit-time for any calendar month after consummation of the Transaction is adversely affected relative to that Shipper's average transit for the corresponding base period calendar month and (ii) a period of not more than 30 days after the date of receipt of such Shipper notice for CN to bring the average transit-time for the movement or movements in question up to the base service level for the corresponding base calendar month..
- d) Provides remedies if that Shipper's average monthly transit-time continues to be adversely affected by the Transaction for more than 30 days after the date of such notice. Such remedies, to be applied during the period of degraded service, will include, at a minimum, on-the-ground management flexibility and top-level backing with whatever resources are necessary to effect a complete and timely resolution. The Shipper and Rail Carriers may agree to remedies for service level declines in addition to or in lieu of the remedies provided for in this Agreement. During the two year period after consummation of the Transaction, if a Shipper's average transit time calculated over a calendar month for a particular movement exceeds that for the corresponding base period calendar month, the Rail Carriers shall have the burden of showing that the adverse effect was not a result of the Transaction.
- e) The Shipper and Rail Carriers may agree to provide for a sliding scale of charges based on the Rail Carrier's performance for that Shipper after the Transaction relative to that Shipper's base service levels.
- f) Unless otherwise agreed to by the Shipper and the Rail Carriers, any agreement made pursuant to this section 2 shall expire five years after the consummation of the Transaction.

3) Interchange Protection.

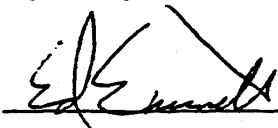
- a) At the request of a Shipper, subject to any necessary concurrence of Rail Carriers' connections, Rail Carriers will establish and maintain in effect commercially reasonable contract through rates and charges that are applicable to the transportation of property for that Shipper originating on or destined to points on WC over any existing interchange between WC and any other rail carrier that was active during the 12 months prior to the date of this Agreement.
- b) Within the five year period subsequent to the consummation of the Transaction, Rail Carriers, except as provided below, will not increase their portion of common carrier through rates that are in effect upon the date of the consummation of the Transaction and that are applicable to the transportation of property via interchanges to or from origin or destination points on WC and have been used to ship the commodity in question in the prior 12 months. The Rail Carriers' portion of such existing common carrier through rates may be

increased by no more than the change, if any, in the Unadjusted Rail Cost Adjustment Factor ("RCAF-U") or, if the Rail Carriers so choose, the change in the RCAF-U minus any fuel cost element of the RCAF-U plus any cost-based fuel surcharge applied by the Rail Carriers.

- c) After the expiration of the five-year period subsequent to the consummation of the Transaction, Rail Carriers will not close, by any commercially unreasonable means, any interchange between WC and any other rail carrier then in active use.
- 4) **Applicability of this Agreement.** This Agreement was negotiated on the expectation that CN will consummate the acquisition of control of WC. Other than the League's obligations under paragraph 1 hereof, the rights and obligations set forth in this Agreement are contingent upon and will become effective only on the date of such consummation. This Agreement will have no continuing force or effect if the STB does not authorize or CN does not consummate the Transaction. However, if CN does consummate the transaction, then any individual Shipper over CN or WC affected by any of the provisions of this Agreement shall be a third-party beneficiary of this Agreement. No party other than such a Shipper, the League and the Rail Carriers shall be a beneficiary of this Agreement.
- 5) **Dispute Resolution.** If a dispute arises under this Agreement or any agreement formed pursuant to this Agreement, the exclusive means by which any party to or beneficiary of this Agreement or any agreement formed pursuant to this Agreement may unilaterally seek third party dispute resolution shall be arbitration as provided in an agreement between a Shipper and the Rail Carriers or, if no such provision has been made, under the Commercial Arbitration Rules administered by the American Arbitration Association. In any case, arbitration shall be decided no more than 90 days from the selection of the arbitrator.
- 6) **Governing Law.** This agreement will be governed by the law of the District of Columbia, without regard to rules pertaining to choice of law.



Canadian National Railway Company



Edward M. Emmett, President
The National Industrial
Transportation League

ATTACHMENT 2

CN Sales and Marketing



455 Cityfront Plaza Drive
Chicago, IL
60611-5317

April 25, 2001

Mr. Edward M. Emmett
President
The National Industrial Transportation League
1700 N. Moore Street, Suite 1900
Arlington, VA
22209-1904

Dear Ed,

This will confirm that, upon the execution of the NITL/CN Agreement regarding NITL's support for the CN/WC Transaction and the acceptance by the Surface Transportation Board of the CN/WC Application as one for STB approval of a minor transaction, CN will request that the STB impose a condition on the approval of the Transaction that Applicants will adhere to the following representation made in their Application:

Applicants will also waive any defenses they might otherwise have as a result of the Transaction, under the Board's general rule that it does not separately regulate bottleneck rates, in circumstances where a shipper prior to the Transaction would have been entitled to regulation of a bottleneck rate under the Board's "contract exception" to the general rule.

Sincerely,

A handwritten signature in black ink, appearing to read 'James Foote', with a small flourish at the end.

James Foote
Executive Vice President Sales and Marketing

REDACTED - To be filed on the public record

TM-23

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**Comments Exhibit 9
Public**

Finance Docket No. 32760

**UNION PACIFIC CORP., UNION PACIFIC RR. CO. AND
MISSOURI PACIFIC RR CO.
- CONTROL AND MERGER -
SOUTHERN PACIFIC RAIL CORP., SOUTHERN PACIFIC
TRANS. CO., ST. LOUIS SOUTHWESTERN RW. CO.,
SPCSL CORP. AND THE DENVER AND RIO GRANDE WESTERN CORP.**

Finance Docket No. 32760, Sub No. 13

**THE TEXAS MEXICAN RAILWAY CO.
- TRACKAGE RIGHTS OVER LINES OF
THE UNION PACIFIC RR. CO. AND SOUTHERN PACIFIC TRANS. CO.**

Finance Docket No. 32760, Sub No. 14

**THE TEXAS MEXICAN RAILWAY COMPANY
- TERMINAL TRACKAGE RIGHTS OVER LINES OF
THE HOUSTON BELT & TERMINAL RAILWAY CO.**

**RESPONSIVE APPLICATION OF
THE TEXAS MEXICAN RAILWAY COMPANY**

Richard A. Allen
Andrew R. Plump
John V. Edwards
Zuckert, Scoutt & Rasenberger, LLP
888 17th Street, N.W., Suite 600
Washington, D.C. 20006-3939
(202) 298-8660
Attorneys for The Texas
Mexican Railway Company

March 29, 1996

Finance Docket No. 32760

The Texas Mexican Railway Company ("Tex Mex"), hereby applies under 49 U.S.C. §§ 11343-45¹⁷ and the Board's Railroad Consolidation Procedures, 49 C.F.R. part 1180, for the grant of conditions upon the merger transaction proposed by the Union Pacific Corporation, Union Pacific Railroad Company, Missouri Pacific Railroad Company,

17 The ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (the "Act"), enacted on December 29, 1995 and effective January 1, 1996, abolished the Interstate Commerce Commission ("ICC") and transferred certain functions and proceedings to the Surface Transportation Board ("Board"). Section 204(b)(1) of the Act provides, in general, that proceedings pending before the ICC on the effective date of that legislation shall be decided under the law in effect prior to January 1, 1996, insofar as they involve functions retained by the Act. This responsive application relates to a proceeding that was pending with the ICC prior to January 1, 1996, and to functions that are subject to the Board's jurisdiction pursuant to Sections 11323 through 11325 of the Act. Therefore, this responsive application is submitted pursuant to the law as it was in effect prior to the Act, and citations are to the former sections of the statute and regulations, unless otherwise indicated.

SECTION 1180.6(a)(1)(iii)

PURPOSE

On November 30, 1995, the Applicants filed an application for the merger of the Union Pacific and the Southern Pacific railroad systems. Tex Mex has analyzed the Applicants' Railroad Merger Application in light of the Board's Railroad Consolidation Procedures and General Policy Statement (49 C.F.R. § 1180.1). As set forth in more detail below and in the verified statements of its witnesses, Tex Mex has determined that both potential harms to the public identified in the Board's regulations at 49 C.F.R. § 1180.1(c)(2) (reduction in competition and harm to essential services) will result from the proposed railroad consolidation.

Applicants entered into an agreement with the Burlington Northern Railroad Company and the Atchison, Topeka and Santa Fe Railway Company which the Applicants claim addresses these competitive concerns. Analysis of the effects of the agreement conducted by Tex Mex witnesses Larry Fields, Brad Skinner, Curtis Grimm, and Joseph Ellebracht indicate, however, that the BN/Santa Fe Agreement falls far short of remedying the serious anticompetitive effects and threat to essential services of the merger, particularly as to U.S.-Mexico rail traffic moving through the Laredo rail gateway. The purpose of this responsive application is to address the competitive problems and loss of essential services that will result from the proposed merger and that are not remedied by the BN/Santa Fe Agreement.

The Southern Texas-Mexico Railroads and the Laredo Gateway:

Laredo is the principal gateway for rail traffic between the United States and Mexico. A majority of all rail traffic moving between the United States and Mexico moves over this

gateway. Of all the U.S.-Mexico rail border crossings, it is supported by the strongest infrastructure of customs brokers and provides an effective routing in Mexico to the major Mexican destinations.

Laredo is served by two railroads: Tex Mex and the UP. Tex Mex is a Class II railroad that has been providing rail service since 1875 over its 157-mile line of railroad from Laredo, Texas on the U.S.-Mexico border to Robstown, Texas, where it meets up with UP, and on to Corpus Christi, Texas on the Gulf of Mexico where it meets up with a branch line of UP.

UP is a Class I railroad that stretches the length and breadth of the Western United States. In South Texas, UP has a line that runs from San Antonio, Texas to Laredo. UP also has a line that runs along the Gulf of Mexico from Algoa, Texas (located just south of Houston) to Brownsville, Texas on the U.S.-Mexico border (the "Brownsville Line"). Tex Mex connects with UP's Brownsville Line at Robstown. Tex Mex also connects with UP at Corpus Christi which is on a branch off the Brownsville Line.

The Southern Pacific Transportation Company ("SP") has trackage rights over portions of UP's Brownsville Line and its Corpus Christi branch line that permit it to interchange traffic there with Tex Mex. Although Tex Mex meets both UP and SP in Corpus Christi, nearly all of traffic that it has interchanged at Corpus Christi has been with SP. For many years Tex Mex and SP have provided the competitive alternative to the UP's San Antonio-Laredo service for U.S.-Mexican rail traffic through the Laredo U.S.-Mexico gateway.

urge the Surface Transportation Board to condition any approval of the merger at least upon granting the rights that Tex Mex seeks in this responsive application.

SECTION 1180.6(a)(2)(i)
EFFECTS ON COMPETITION

Each of the witnesses who present verified statements for Tex Mex addresses the effects of the proposed merger, as conditioned by the BN/Santa Fe Agreement, and as further conditioned by the rights requested herein. This section summarizes the more detailed analysis presented in those statements.

1. Effects On Competition of the Proposed Merger and the BN/Santa Fe Agreement Without the Rights Sought Here.

The general conclusion of Tex Mex's witnesses is that the proposed merger would reduce competition in the markets served by Tex Mex -- especially the market for the transportation of goods between the United States and Mexico -- to a serious and unacceptable degree. They also conclude that the BN/Santa Fe Agreement would do little to restore the competition that would otherwise be lost, for two principal reasons.

First, even if the agreement enabled BN/Santa Fe to function as a perfect competitive substitute for an independent SP, the merger would still result in an unacceptable loss of competition in the markets served by Tex Mex because it would eliminate one of the three major U.S. railroads serving U.S.-Mexican gateways and would thus leave many shippers throughout the United States with only two railroads competing for their business where now they have three. Curtis M. Grimm, Professor of Transportation, Business and Public Policy at the College of Business and Management, University of Maryland, explains in his verified

statement how this loss of one of the three competitors in the market for transportation of goods between the United States and Mexico will cause a very substantial loss of competition. Professor Grimm's conclusions about the general anticompetitive effects of reducing the competitors in a market from three to two are supported by empirical studies and are reflected in the Department of Justice's merger guidelines. Larry Fields, Tex Mex's president, and transportation consultant Joseph Ellebracht, also testify on the basis of their many years experience in the railroad industry, including Mr. Ellebracht's 14 years marketing rail services for SP, that shippers benefit significantly in rates and service from having three railroads rather than two competing for their business.

Furthermore, BN/Santa Fe's probable share of the market for U.S.-Mexico traffic is likely to be too small compared to a merged UP/SP's share to induce it to devote the resources needed to compete effectively for the traffic. Consequently, a merged UP/SP will dominate the market so substantially, that BN/Santa Fe's capacity to constrain UP/SP's pricing for most shippers will be minimal. For most shippers, therefore, the reduction in carriers will effectively be from two to one.

Second, the agreement will not enable BN/Santa Fe to function as a perfect, or even acceptable, competitive substitute for an independent SP -- certainly not in the markets served by Tex Mex, in any event. As both Mr. Ellebracht and Allen Haley explain, in place of SP's current operations over its own tracks, the agreement proffers as a substitute BN/Santa Fe operations via trackage or haulage rights, subject to UP/SP's traffic control, over a UP line that is substantially more congested and, for much of the traffic, more circuitous than SP's lines. Mr. Fields and Brad Skinner, a director of Tex Mex, and

Director of Multimodal Operations for Tex Mex's ultimate parent, Transportacion Maritima Mexicana ("TMM"), also describe a number of specific reasons to believe that BN/Santa Fe will have little interest in devoting the resources and efforts necessary to be an effective competitor to a merged UP/SP for this traffic, and that is why the Applicants gave BN/Santa Fe these rights and refused to give Tex Mex the rights it seeks.

Accordingly, if the proposed merger with the BN/Santa Fe agreement were approved, it would very likely cause a substantial lessening of competition for rail transportation of goods between the United States and Mexico. Professor Grimm and Mr. Ellebracht show that this is not traffic that can feasibly move by other modes. More than 80 shippers who depend on Tex Mex have also submitted statements expressing their concerns about the expected loss of competitive alternatives and their support for the rights Tex Mex seeks.

As Brad Skinner discusses, the result of this lessening of competition will seriously undermine the benefits that the United States, Mexico and Canada expect to derive from the North American Free Trade Agreement. It is also likely to undermine Mexico's present efforts to bring new efficiency and competition to the Mexican rail system through privatization. It will also frustrate the efforts that TMM is making, in partnership with Kansas City Southern Industries, Inc. ("KCSI"), to create a rail network between central Mexico and the central United States that will provide a strong competitive alternative to a merged UPSP system for rail transportation between Mexico and the United States and between Mexico and Canada.

SECTION 1180.6(a)(2)(iv)
EFFECT ON ADEQUACY OF TRANSPORTATION

Tex Mex believes that granting the rights sought in this responsive application is necessary to preserve adequate rail transportation services to the public in two respects:

First, it is necessary to prevent an unacceptable loss of competition in the markets served by Tex Mex for the reasons previously summarized in Section 1180.6(a)(2)(i).

Second, in light of Mr. Krick's conclusion that the merger without these rights is likely to result in Tex Mex's going out of business, granting the requested rights is necessary to prevent a loss of all Tex Mex's rail service. As shown by their supporting statements, a number of Tex Mex shippers are very dependent on Tex Mex for their transportation needs and cannot practically use other modes of transport. Corpus Christi Grain Company, for example, depends entirely on Tex Mex to transport its grain to Mexican customers; neither trucks nor any other railroad is a feasible alternative for that traffic. Indeed one shipper, Barr Iron and Metal Company in Alice, Texas states that it "would probably have to close our operations down" if Tex Mex went out of business. Accordingly, without the requested conditions, the merger will cause the loss of essential rail services as well as an unacceptable reduction in competition.

SECTION 1180.6(a)(2)(v)
EFFECT ON EMPLOYEES

Imposing the conditions Tex Mex requests will not result in the abolition or transfer of any Tex Mex employee position. On the contrary, Tex Mex anticipates that it will need to hire between 30 and 40 employees to operate the traffic anticipated from the rights Tex

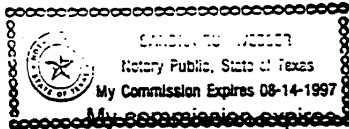
**SIGNATURES, OATHS, AND CERTIFICATIONS
OF APPLICANT'S EXECUTIVE OFFICERS
SECTION 1180.4(c)(2)(i)²⁵**

STATE OF TEXAS)
)
COUNTY OF WEBB)

Larry Fields, being duly sworn, deposes and says that he is President of the Texas Mexican Railway Company, applicant herein, that he is one of the executive officers duly authorized to sign, to verify and to file this Responsive Application on behalf of The Texas Mexican Railway Company, that he has knowledge of the matters contained in this Responsive Application, and that his statements made in this Responsive Application are true and correct to the best of his knowledge and belief.

Larry W. Fields
LARRY FIELDS)

Subscribed and sworn to before me this 26th day of March 1996.



Sandra A. Webber
NOTARY PUBLIC
My commission expires as of 8-14-97.

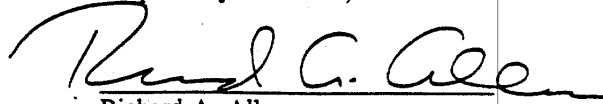
I, Walter L. Winters, II, hereby certify that I am Secretary of The Texas Mexican Railway Company, the applicant herein, and that Larry Fields, President of The Texas Mexican Railway Company, is duly authorized to sign, to verify, and to file this Responsive Application on behalf of The Texas Mexican Railway Company.

Walter L. Winters, II
Secretary

Dated this 26 day of March, 1996, at Laredo, Texas.

²⁵ In UP/SP, Decision No. 14 the Board waived compliance with 49 C.F.R. § 1180.4(c)(2)(i) requiring that "[a]ny person controlling an applicant shall also sign the application" as that requirement relates to Transportacion Maritima Mexicana S.A. de C.V. ("TMM") and Mexrail. Slip op. at 4.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Richard A. Allen", written over a horizontal line.

Richard A. Allen

Andrew R. Plump

John V. Edwards

ZUCKERT, SCOUTT & RASENBERGER, LLP

888 Seventeenth Street, NW

Suite 600

Washington, DC 20006-3939

(202) 298-8660

Attorneys for Texas Mexican Railway Company

Dated: March 29, 1996

VERIFIED STATEMENT

OF

LARRY FIELDS

My name is Larry Fields. I am the President of the Texas Mexican Railway Company ("Tex Mex"), headquartered at 1200 Washington St, Laredo, Texas 78042. I am submitting this statement in support of the responsive application being filed by Tex Mex in Finance Docket 32760 seeking trackage rights over UP and SP lines between Robstown, TX and Beaumont, TX.

I have worked in the railroad industry since going to work for the Kansas City Southern Railroad's ("KCS") maintenance of way department in 1965. I worked for KCS in various capacities between 1965 and 1991; my last position was Vice President Operations. From 1991 to 1993 I consulted on rail operations and privatization of lines in Africa and Russia. In 1993 and 1994 I was general manager of a short line railroad. I became president of the Tex Mex on December 1, 1994. I have a bachelor of science degree from Kansas State Teachers College and a masters of business administration degree from Rockhurst College.

INTRODUCTION AND SUMMARY

Currently, the Southern Pacific ("SP"), in conjunction with Tex Mex, provides the only effective competition to the Union Pacific Railroad ("UP") over a vital rail corridor that accounts for a majority of the railroad traffic between the United States and Mexico. In my opinion, it is absolutely critical to

successful, those efforts will enable TMM, KCS and Tex Mex together to provide rail service in both Mexico and the United States that could, in the right circumstances, compete very effectively with a merged UPSP for rail traffic between the United States and Mexico. They will not be able to provide truly competitive service, however, unless Tex Mex connects directly with KCS at Beaumont, TX. In my opinion, UP and SP know this to be true, and that is why they refused KCS's and Tex Mex's request for trackage rights that would provide such a connection and instead granted the rights to BNSF.

II. IMPACT OF THE UP/SP MERGER ON COMPETITION IN MARKETS SERVED BY TEX MEX

As discussed in greater detail in the verified statements of Professor Grimm and Mr. Ellebracht, unless it is properly conditioned, merger of the UP and SP would effectively eliminate rail competition in transportation markets served by Tex Mex. The most important such market is for the transportation of goods between the United States and Mexico. Without conditions, the merger would give the merged UPSP complete control over the all-important Laredo gateway. In 1994 that gateway handled 57% of the rail traffic between the two countries.

An unconditioned merger would also give the merged UPSP complete control of the Brownsville gateway and substantial control of the gateway at Eagle Pass, TX which is currently served by SP's line and access to which BNSF has only via haulage rights. Laredo, Brownsville and Eagle Pass together accounted for 80% of the rail traffic between the U.S. and Mexico and

virtually all of the traffic between the U.S. and Mexico's industrial centers in central and eastern Mexico. Ellebracht V.S. at 17.

That loss of rail competition will have an extremely adverse affect on rail shippers, who have no feasible transportation alternatives. Although most of the transportation of freight between the U.S. and Mexico is carried by truck, truck and water transportation are not practical alternatives for almost all of the shipments now transported by rail. Ellebracht V.S. at 31-34; Professor Grimm concurs in this conclusion and cites supporting evidence provided by many of Tex Mex's shippers.

UP and SP are well aware that an unconditioned merger would eliminate rail competition in the market for U.S.-Mexico rail transportation. That is why they have proposed to give trackage rights and haulage rights to BNSF over the UP line from Algoa, just south of Houston, to Robstown (where BNSF may connect with Tex Mex) and continuing to Brownsville (where BNSF may connect with Ferrocarriles Nacionales de Mexico ("FNM")), and also to give BNSF trackage rights over SP's line to Eagle Pass (to replace BNSF's current haulage rights.) UP and SP claim that those rights will preserve the competition that would otherwise be lost, and they would certainly never have granted such rights unless they recognized that an unconditioned merger would result in an unacceptable loss of competition in this market.

The problem with the solution that UP and SP have proposed is that there is a very high likelihood that BNSF will not be an

adequate substitute for an independent SP in this market, for many reasons which are summarized below. It is, of course, not possible to predict the impact of future events and future competitive behavior with absolute certainty, but that is a risk that the United States and Mexico cannot afford to take.^{2/}

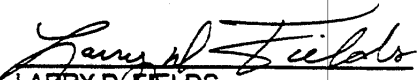
III. WHY BNSF WILL NOT BE AN ADEQUATE COMPETITIVE SUBSTITUTE FOR AN INDEPENDENT SP.

Professor Grimm, Mr. Ellebracht and Mr. Haley discuss in detail the reasons why BNSF will not be an adequate competitive substitute for an independent SP for U.S.-Mexican traffic under the terms of BNSF's agreement with UP and SP. The first, and perhaps most important, is the simple fact that today there are three major Class I railroads with access to Mexican gateways. After the merger, even as conditioned on the BNSF settlement agreement, there will be only two major railroads with access to Mexican gateways -- UPSP and BNSF. As Professor Grimm explains, the evidence is compelling that the reduction of the number of railroads serving a market from three to two will cause a significant loss of competition that is likely to result in substantial increases in rates.

^{2/} If I am correct that BNSF will not be as effective a competitor for traffic between the U.S. and Mexico, particularly through Laredo, the result would not only be an unacceptable loss of competition for that traffic but would also probably put Tex Mex out of business, as shown by the traffic study performed by Mr. Ellebracht and the financial pro formas developed by Patrick Krick. That event would cause a number of shippers that are now dependent on Tex Mex for transportation to lose essential rail services, as I discuss below.

VERIFICATION

I, Larry D. Fields, certify under penalty of perjury the foregoing is true and correct. Executed on March 25, 1996.


LARRY D. FIELDS

VERIFIED STATEMENT
OF
JOSEPH F. ELLEBRACHT

My name is Joseph F. Ellebracht. I am an independent railroad transportation consultant. My office is at 1015 Jackson Avenue, River Forest, Illinois 60305.

Qualifications and Experience

Before establishing my consulting practice in March of 1993, I was employed for nineteen years in the railroad industry in a variety of marketing positions. My most recent railroad employer was the Southern Pacific Transportation Company, where I worked for fourteen years, and before that I worked for the Chicago, Rock Island and Pacific Railroad. I hold a B.A. degree from Washington University and a M.B.A. from the University of Missouri.

During my railroad employment I worked with dozens of railroads, hundreds of railroad customers and thousands of railroad marketing and operating personnel. This experience provided me with knowledge of what buyers and sellers of rail transportation want, and also of the means employed to achieve those wants. During my employment at SP, and after, as a consultant, I participated in a number of railroad acquisition cases as well as other proceedings before the Interstate Commerce

the Mexico-U.S. gateways. BNSF may make minor gains at Eagle Pass, Brownsville and Laredo from the trackage rights granted, but in every case BNSF has been given an inferior route to these gateways compared to that of SP, and an even more inferior route compared to that of UPSP. If the merger is approved as proposed, UPSP will handle nearly all of the traffic to and from Mexico.

The elimination of SP as an independent competitor for U.S-Mexican traffic and the resulting control that UPSP will have over virtually all of that traffic will cause a very substantial loss of competition and will create the climate for a significant increase in rail rates.

While it is true that there is currently only one railroad in Mexico, FNM, the state-owned railroad, that fact has not diminished the benefits shippers have enjoyed to date from the competition among U.S. railroads for that traffic. For a number of reasons, including FNM's ratemaking practices, the different currencies used by the two countries, the unpredictable fluctuations in the exchange rates and the normal transition of ownership of the freight at the border, nearly all U.S. rail rates for traffic to or from Mexico are established only for the U.S. portion of the move. Similarly, FNM rates cover only the Mexican portion. Few rates are established with FNM on a through or joint-rate basis. In my years of marketing for SP, I was directly involved in a few efforts to establish through rates for selected traffic. Such rates, however, have not generally been encouraged by FNM, entail significant administrative and

potential tax burdens, and are requested by very few customers. The vast majority of international rates are made by combining the rate within Mexico and the rate within the United States.

Furthermore, FNM's rates are generally set on a distance basis and, in my experience, have rarely been set in consideration of the rates charged by U.S. railroads for the U.S. portion. As a recent study of U.S.-Mexico traffic by the University of Texas states: "FNM continues to set its rates using the old fixed-rate system. Under this fixed rate system, prices are set according to a distance-based tariff. FNM gives each commodity a class number. Prices are then determined by cross-referencing the class number with the distance to be travelled. The distance factor is set independent of any other variables such as geography and accessibility."^{2/}

Because FNM sets its rates for the Mexican portion of international traffic without regard to the rates for the U.S. portion, the vigorous competition that now exists between U.S. railroads for that traffic directly benefits the shippers, and any reduction in that competition will harm them. UP, SP and their witnesses have not disputed this fact. Indeed, the Applicants' settlement agreement with BNSF, which Applicants argue will preserve that competition, clearly reflects their recognition of the serious anticompetitive effect that an

^{2/} Lyndon Johnson, School of Public Affairs, the University of Texas at Austin, U.S.-Mexico Trade and Transportation: Corridors, Logistics Practices and Multimedia Partnerships, Policy Research Project Report Number 113 (Austin, Texas: 1995).

unconditioned merger would have on competition for U.S.-Mexico rail transportation. Unfortunately, as I discuss later, Applicants are wrong that the settlement agreement will preserve the competition that now exists for that traffic.²

B. The Elimination of SP As An Independent Competitor For U.S.-Mexico Traffic Will Cause A Substantial Reduction in Competition.

Contrary to Applicants' claims, BNSF trackage rights or, more likely, haulage rights operations between Houston, Corpus Christi and Brownsville will provide a significantly inferior level of competition to UP for traffic through Laredo than UP now faces from SP in conjunction with Tex Mex or than UPSP would face from Tex Mex if Tex Mex could connect directly in Houston and Beaumont with railroads serving those points. This is true for several reasons that I discuss more fully in the following Section 4.C.

A more fundamental, threshold problem with the proposed UP/SP merger and the BNSF settlement, however, is that, even if one assumed that BNSF would be just as effective a competitor using its trackage and haulage rights as SP is now operating over its own lines, the fact remains that today there are three major

² As I have discussed, because FNM sets its rates without regard to the rates charged by U.S. railroad's, FNM's monopoly over the Mexican portion of international moves has not prevented the benefits of competition among U.S. railroads from flowing through to the shippers. As I discuss in Section 4.E, below, the converse situation cannot be expected to hold true. If Mexico establishes a significant degree of competition in its rail system, as is expected, the benefits of that competition would not be likely to flow through to shippers if the U.S. portion of the transportation becomes noncompetitive.

conjunction with KCS, intends to bid for both of those divisions. UP, in conjunction with its Mexican partner, is expected to be another major bidder. TMM expects that the Mexican government will require the purchaser of the first, and perhaps the second, division to provide trackage rights to another carrier to ensure competition over those lines. The process is expected to be completed before the end of the year.

Mexico's efforts to bring competition and efficiency to its rail system, however, would be largely undermined if competition is lost on the U.S. side of the border. UP, SP and BNSF are all very sophisticated in setting rates to maximize profits. Each of them, including a merged UPSP, can be expected to set rates as high as competitive constraints will permit them. To the extent that UPSP and BNSF, both individually or together, will control gateways and routes within the U.S., they can be expected to use that control to the fullest to maximize their revenues on U.S.-Mexico traffic. If competition among Mexican carriers reduces rates for the Mexican portion of such moves, U.S. carriers with control over the U.S. portion can be expected to appropriate those reductions for their own benefit, not the shippers' benefit.

F. Intermodal Competition Alone Is Not Enough to Constrain Rail Prices on Shipments to and from Mexico via Laredo

The table below shows the major commodities handled via Laredo by rail in 1994.

Truck competition will not be an effective constraint on rail prices in the absence of effective rail-to-rail competition.

The inland location of Mexico's major industrial and population centers reduces the attractiveness of water service for the commodities listed in the above table. Generally, for the traffic handled via Laredo, a water-borne shipment would require a relatively long inland leg in both the United States and Mexico. Mexico City is 419 kilometers from the major port of Veracruz. Monterrey is approximately 160 kilometers from the coast. Guadalajara is 313 kilometers from the port of Manzanillo, which is a Pacific port, and would require a long water voyage in addition to a land leg for most of the shipments that are transported through Laredo. Water competition will not be an effective constraint on rail prices in the absence of effective rail-to-rail competition.

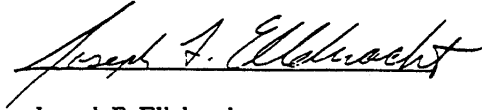
G. There Are Serious Risks Associated with the UP/SP-BNSF Settlement Agreement

BNSF may simply fail to exercise its trackage rights. BNSF is under no obligation to fully exercise its trackage/haulage rights to Corpus Christi. Traffic that SP found attractive, with SP's more direct route, may be unattractive to BNSF, which has been relegated to a less direct route. BNSF's bids to shippers will reflect its more circuitous route, as well as the more variable level of its payments for track and maintenance. As a result, BN's bids are likely to be higher than those made by SP, allowing UP to also raise its bids. As a result, the customers will pay more, either to BNSF or to UPSP. BNSF will pursue only

VERIFICATION

I, Joseph F. Ellebracht, certify under penalty of perjury the foregoing is true and correct.

Executed on March 25, 1996.

A handwritten signature in cursive script, reading "Joseph F. Ellebracht", written in black ink.

Joseph F. Ellebracht

VERIFIED STATEMENT

OF

CURTIS M. GRIMM

I. INTRODUCTION AND SUMMARY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

VERIFICATION

I, Curtis M. Grimm, certify under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this verified statement on behalf of The Texas Mexican Railway Company. Executed on this 28th day of March, 1996.

Curtis M. Grimm
Curtis M. Grimm

CASE NOT SCHEDULED FOR ORAL ARGUMENT
AS OF THIS FILING

No. 96-1373, et al.

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

WESTERN COAL TRAFFIC LEAGUE, ET AL.,
Petitioners

v.

SURFACE TRANSPORTATION BOARD
AND UNITED STATES OF AMERICA,
Respondents

and

UNION PACIFIC, ET AL.,
Intervening Respondents

ON PETITIONS FOR REVIEW OF ORDERS OF
THE SURFACE TRANSPORTATION BOARD

BRIEF OF RESPONDENT
SURFACE TRANSPORTATION BOARD

HENRI F. RUSH
General Counsel

LOUIS MACKALL, V
Attorney
Surface Transportation Board
Washington, D.C. 20423-0001

TYPEWRITTEN COPY

DECEMBER 1997

to grant access to others. The Board has consistently approved such procompetitive, voluntary agreements as in the public interest. Moreover, the Board has imposed procompetitive agreements as conditions consistent with the public interest at the request of applicants and settlement parties, even if it would not have imposed such conditions absent the agreement. But the Board has consistently refused to require the parties to such agreements to extend them to other shippers. See, e.g., BNSF, slip op. at 99, rejecting similar arguments of Bunge Corporation, and Decision No. 44, at 183 rejecting similar arguments of various Montana interests.⁴² Enterprise has not shown that the agency's longstanding approach, which fosters pro-competitive settlement agreements, is arbitrary and capricious.

IV

THE BOARD PROPERLY GRANTED TEX MEX TRACKAGE RIGHTS OVER BNSF'S OBJECTIONS

BNSF obtained a voluntary settlement agreement, which, with numerous modifications mostly favorable to BNSF, was imposed by the Board as a merger condition. As a result, BNSF obtained access to hundreds of new shippers and the right to use new, more efficient routes for any of its traffic over thousands of miles of new lines as a result of this merger. Yet BNSF is not

⁴² In any event, Enterprise stands in somewhat of a different position than Chevron, Amoco, and Exxon, since they supported UP's application to build the Mt. Belvieu branch, and made contractual commitments to use it. Enterprise provided no support and made no commitments.

satisfied. Apparently, BNSF believes that the Board has infringed upon its exclusive proprietary right to use these new trackage rights by permitting Tex Mex to overlap them over a tiny, 50-mile segment. BNSF has this situation exactly backwards. BNSF is only operating over these lines as a result of the Board's approval of this merger, and its approval (and imposition as conditions) of various related settlement agreements as in the public interest. With the merger or without it, BNSF would have needed the approval of the STB under section 11343 to obtain such trackage rights.

It is well settled that the Board has broad discretion in determining what conditions are necessary in a merger proceeding. It is also undisputed that the merger without conditions would have resulted in significant competitive harm south of Houston, particularly in the U.S.-Mexico trade over the important Laredo gateway, which is served only by UP and Tex Mex. The Board had a wide range of options available to it to preserve competition; by no means was the Board constrained to choose the solution proposed by the applicants, total reliance on BNSF. The Board could have declined to approve or permit this portion of BNSF's trackage rights, and could have given Kansas City Southern Railway Company, Tex Mex, or some other carrier exclusive trackage rights over UP to replace the service formerly provided by SP. Instead of choosing either of these exclusive options, the Board chose an option that preserved a limited role for Tex Mex in providing a part of an alternative route for shipments

moving to and from Mexico. At the same time, the Board also approved BNSF's trackage rights service under the BNSF settlement agreement to preserve access to the extensive BNSF system for shippers.

It is true that the Board has a policy of not imposing protective conditions in a merger proceeding except where necessary to preserve essential services or to prevent significant competitive harm. As BNSF correctly points out, the ICC and the Board have generally subjected parties seeking such relief to an exacting standard of proof. The situation here is unusual in that the potential harm to Tex Mex, and in turn to this important alternative Laredo routing, would be caused not just by the merger itself, but also by the settlement agreement, which gave BNSF a new role in this region.

The settlement agreement was a voluntarily negotiated merger condition that for the most part was procompetitive and in the public interest. Indeed, without the settlement agreement, it would have been impossible to approve this merger. But that does not mean that the Board was required to endorse or permit every part of the agreement and impose it alone as a condition. The Board properly declined to impose conditions giving exclusive access south of Houston to BNSF, conditions that could have resulted in Tex Mex being forced out of the market, and its assets being sold to some other carrier, most likely BNSF.

It is not clear to us how BNSF was harmed by the Board's remedy other than by the fact that it has lost the ability to use

Comments Exhibit 11
Public

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EVT 05:40 Final Event Transcript of KSU conference call, 29-Apr-03 1:00pm

Q1 2003 Kansas City Southern Earnings Conference Call

Boston, Apr 30, 2003 (CCBN StreetEvents) -- Event Transcript of Kansas City Southern conference call, 29-Apr-03 1:00pm ET.

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Corporate Participants

- * Michael Haverty
Kansas City Southern - Chairman President and Chief Executive Officer
- * Gerald Davies
Kansas City Southern - Executive Vice President and Chief Operating Officer
- * Ronald Russ
Kansas City Southern - Executive Vice President and Chief Financial Officer
- * Jim Jones
Manatt Phelps and Phillips - Board Member

Conference Call Participants

- * Jennifer Ritter
Lehman Brothers
- * Tom Waterditz
Bear Stearns
- * Orlando Mushan
Great T Capital
- * Arthur Shield
Roosevelt Investment Group

Presentation

Operator [1]

Good afternoon, my name is Amy, and I'll be your conference facilitator today. At this time, I'd like to welcome everyone to the Kansas City Southern 1st quarter earnings conference call. All lines have been placed on mute to prevent any background noise. If you should need assistance during the call, please press star then zero, and an operator will come back on line to assist you.

Thank you, I will now turn the call over to Mr. Michael Haverty, Chairman,

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President and CEO of Kansas City Southern. Sir, you may begin.

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [2]

Good afternoon to all of you here in New York and all of you who have joined us on the telephone and welcome to Kansas City Southern's combination 1st quarter 2003 presentation as well as a presentation that we want to talk about that deals with the announcement that we made last week regarding the NAFTA Rail transaction, where we will put Kansas City Southern, Tex-Mex and TFM under a single company.

Joining me today as speakers in the presentation, dealing with the 1st quarter will be Gerald Davies, our Executive Vice President and Chief Operating Officer, and also, Ron Russ our Executive Vice President and Chief Financial Officer.

As we look at the first quarter earnings, there's not really a way to put a good face on this thing. I think very clearly, it's obvious that the quarter was a lousy quarter. When you look at the ongoing earnings per share, 8 cents versus 19 cents a year ago, but there are some things clearly that led to having a poor first quarter.

Let me say, first of all, that the first quarter historically for both Kansas City Southern and TFM is the worst quarter of the four. But this quarter was really exacerbated by two things, number one, the uncertain economy in the United States and Mexico tags onto what goes on in the United States and as a result there were some effects on revenues in Mexico. In addition to that, the peso value in Mexico and half of our revenues coming from pesos, we saw a downturn on the revenues there, I'll talk about that in just a little bit.

But also, in addition to the economy and the peso devaluation, fuel prices clearly affected the company in the U.S., the fuel prices were up about 45%, or about \$3.3 million and in Mexico, they were up about \$5 million or about 40%. We hedged in the United States, about 32% of our purchases, and in Mexico, we were unhedged or we had not purchased fuel forward as we did in the United States.

So, between the economy and the fuel prices, it clearly affected the earnings negatively in the first quarter. In spite of that, I think there are a lot of good news things that we can talk about in this quarter. First of all, we paid down in a very lousy quarter, just about a million dollars in debt, and we did not draw down on our revolver at the KCS level. We also increased the cash on hand from the end of the 4th quarter of 2002 to the end of this quarter from \$19 million to \$64 million, a \$45 million increase or about a 240% increase in cash on hand.

Also this quarter, the increase of our ownership in group-O TFM that took place in July of last year helped us out on the equity earnings side of TFM where last year at this time we had 36.9% compared to 46.6% of the ownership this year compared to last year. And in the U.S., nearly 60% of the commodity categories

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showed a year-over-year revenue increase, and four out of five of the business units showed they made the forecast that we had projected for this quarter and so we were on target with four out of the five business units.

Another good news story, is MCS that we implemented during the 3rd quarter of last year, is working. All the congestion we had in the past is a thing of the past, and the railroad is running very smoothly. And when you look at the expense side in the U.S., in spite of a 3% wage increase and in spite of increases in health and welfare benefits that were about 5%, and if you exclude the \$3.3 million expense of the fuel cost increase, KCS held the line, and in Mexico, we actually would have reduced expenses had it not been for the fuel increase, the fuel increase there, as I said, was about \$5.5 million and they only ended up being above on expenses a year ago of \$1.5 million. So in reality, without the fuel, they actually reduced the expenses.

So, in spite of a performance that we do not certainly think was good this quarter, there were some good things that happened. And I think we've got some projections looking forward that are going to be positive, and as we talk about our transaction later on in this meeting, I think you'll find that there are some very, very positive opportunities for our shareholders in that transaction.

With that, I'm going to turn it over to Gerald Davies and let Gerald take the presentation and talk about some of the revenues.

Gerald Davies, Kansas City Southern - Executive Vice President and Chief
Operating Officer [3]

Thanks, Mike and good afternoon, it's good to be here this afternoon. I'm going to be relatively brief this afternoon, because we're going to spend a good deal of our time this afternoon talking about the transaction, so I'm going to go through this relatively quickly.

As Mike has already said, despite weak revenue results for the 1st quarter of this year, there have been a number of signs that are very positive for our company. We talked about most of the revenue shortfalls that we expect to see this quarter in our prior meetings, especially the last two. We have three sizable revenue hurdles in each of three business units, one customer in each. We expected in the 1st quarter that we would have been able to offset those revenue declines, but we didn't get much help from the economy, frankly.

In addition, the war as it broke out, which normally helps the railroads, did help us much. Most of our military traffic is related to training exercises. With the war going on, you don't need to move military equipment around for training exercises, so we have far fewer military movements in the 1st quarter of this year than either we had expected or is normally the case.

We track normally 42 individual commodity groups and watch their performance and see what's happening during the course of, frankly, each day. Through the 1st quarter, the majority of those lines of business registered increases and

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even though those that didn't, the increases were relatively small, which as I said, the three exceptions. Four of the five business units as Mike said, registered revenue growth that was ahead of our plan for the year. We had a lot of initiatives that were in place that brought on new customers that expanded the services rendered to existing customers, and brought in additional market share from those existing customers that showed some dramatic improvement in sectors of the business which I'll talk more about in a minute.

Overall, we began the year with a real challenge, as I said. The three areas that we have problems with were coal, plastics and automotive, I have talked about each of these before with you. Coal performed very well, despite the regular decline. The quarter-over-quarter result is skewed by two things, first of all, as I reported before, we had a contract that ended just about a year ago, and, of course, it was not there in the 1st quarter of this year.

In addition, in the 1st quarter of 2002, there were substantial inventory building going on at the utilities we served. This year we didn't have that. Nonetheless, we offset a substantial portion of the revenue decline from the loss of the contract and that inventory loss. If we hadn't had an unexpectedly long maintenance outage, we would have come closer to offsetting it. In the process, we also registered about a 4.5% yield increase in our coal business, that also helped us a lot.

Plastics also performed relatively well, especially given the fact that we had one customer that had a build-in where we lost roughly \$2 million a quarter in revenue for that building. With the growth in business at the other plastics customers and other new customers, we were able to offset roughly half of that loss in the 1st quarter, and we'll continue to work on that growth as we go forward to fully offset it.

The automotive losses that we talked about continue to plague us through this quarter. The contract that we lost in the 2nd quarter of last year, was a major one for us. I continue to believe that we have the service quality and the assets in place to be a major player with the automobile industry. I believe and continue to believe that will happen overtime, we continue to work on it constantly.

With the economic recovery being pretty spotty, as Mike already talked about. We had to be pretty nimble in looking for opportunities to gain business. Our gains in the pulp and paper business really exemplified what went on in the business units in Kansas City Southern in the 1st quarter. The pulp and paper business saw a gain of a quarter of a point in production. This is an ongoing saga for almost three years now in the pulp and paper industry. Nonetheless, the pulp and paper business on KCS increased 14% year over year in the quarter. Pretty sizable gain.

Now, part of that was due to a yield increase. We had about a 3% yield increase in the quarter for paper. So we saw market share gain and a yield increase simultaneously that helped us a great deal. Our intermodal including the college business also grew, about 10% in the quarter, and we saw about a \$900,000

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revenue gain for that line of business in the quarter over a year ago period. The other groups generated relatively small gains, but none--or small decreases, but together, as a whole, they were positive in the smaller sections.

As we worked through the first quarter, we kind of look forward to the rest of the year, we see the second quarter promising slightly higher revenue gains year-over-year, and the 3rd and 4th quarter similarly. Part of that in the 3rd and 4th quarter, will be due to the impact we saw from our MCS implementation last year, we talked about -- we expect to see year-over-year gains from the revenue side as we go through.

Finally, on the revenue side, our Mexico traffic continues to grow. In the 1st quarter of this year, that traffic to and from Mexico over the KCS was up 17%, so it continues its double-digit growth year-over-year.

On the comp side of our equation, we also had two key elements that drove our cost performance. The first is fuel. Mike has already talked a bit about it. The fuel cost increases represent more than 80% of our cost increase year over year in the 1st quarter. Fuel prices were up about 43% over the prior year quarter and our cost increase, 34%, the actual expense that we incurred. That means we had a dramatic increase or improvement in our fuel utilization rates. We had a decline of about 6% in our fuel usage and that is far bigger than the roughly 3% decline than the units handled year-over-year period.

So, we demonstrated the ability to more efficiently use our power building train size and controlling train size, and the production team at KCS performed very well in managing the fuel used in the 1st quarter. Purchase services also saw an increase in expenses. There's a lot of items in purchase services and point to any one as a key driver, there isn't one that really stands out much, except I think there's a major story here in terms of what we pay others to repair our freight cars and locomotives. That price went up relatively sharply, but it really is part of what is a good news story.

Let me explain here. Car hire expenses really have two elements to them. The first is what we pay others for the use of their cars on our system. And the second is what others pay us for our cars on our system and on theirs. In the 1st quarter of this year, we saw the amount that we pay others for the use of their cars drop 8%. That's pretty impressive improvement. We also saw the amounts that others paid us for the use of our cars increase 43%, a huge increase in the 1st quarter. That is the demonstration of the power of MTS in the hands of our managers. They're able much more effectively to target the management of our operations to clearly see what they need to do in the performance.

But there's a bit of a negative on that, when our cars and locomotives are off on other railroad's lines and they do repair for pieces of equipment, they bill us back, so it's an increase in purchase services, which is car repairs and locomotive repairs done by others, because we did a better job at managing our fleet and had it offline a higher portion of the time. That offset some of the gain here but of the 3.4 million saved in car hire, about 2.5 million of that

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was due to the benefits of MTS.

On the smaller increases, wages were up about 1.5%, which I think is a good news story, given that our labor costs increased about 3% in our labor agreement. Fringe benefits were up 4.5%, but a gain with health care costs going up nearly 20%, period over period, there's some good news represented in that too.

Let me talk a little more about fuel. Since it was such a large piece of our cost increase for the quarter. Our fuel usage for the quarter decreased 6%, as I said, that's far greater than the 3% decline in units handled for the period. The growth, as a growth indicator, the fuel consumed dropped per carload handled about 3% period over period. That's a major increase, especially since this is the third year we had to focus on fuel utilization and fuel usage. We continue to see major benefits from it. A gain or indicator of MTS to help us.

Our hedging and over price management activities in the fuel side also helped us. We're about 32% hedged or forward bought in the 1st quarter, which helped us control expenses. In fact, if we hadn't done that, we estimate that our fuel prices -- or fuel costs would have been about 4 1/2 million higher than they were. So the bottom line, the fuel increase of 3.3 million was a result to a good deal of management efforts and control.

Let me summarize real quickly here, as Mike said, we've been through the MTS start-up. That's behind us, we're now in the phase of gaining benefits from MTS. Benefits both for the management of our operations and for the service that we're delivering to our customers. The investment is showing results, and I've given you an example here in the car hire and in the fuel savings.

Our performance measures continue to improve and there's some examples of those at the end of the presentation. I won't take the time to go through them today. But we continue to improve things like train speed on the railroad, but I don't have a bullet on this chart.

I also want to mention safety. In the 1st quarter we had 1.49 incidence for 200,000 hours worked. In the rail car industry, that would put us at 2nd place, the first place carrier has an incidence rate of 1.19 for 200,000 hours of work. So our safety performance continues to improve and we continue our intense focus on the safety of our people, the goods we carry and the communities that we serve.

With that, let me turn this over to Ron Russ, our CFO.

Ronald Russ, Kansas City Southern - Executive Vice President and Chief
Financial Officer [4]

Thanks, Gerald and good afternoon. It was a very difficult quarter, to reiterate what Mike said. I'll be very brief.

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Ignoring the SFAS 143 benefit, ongoing EPS was 8 cents for the quarter, 3 cents from U.S. rail operations and 5 cents from international rail operations. The retirement benefit was from SFAS 143 was about 14 cents a share. On a consolidated basis, KCS operating revenues declined about 2.6% or \$3.7 million. Operating income which Mike and Russ have talked at length about was down about \$6.6 million from the prior year and that is comparable to a situation where we had \$4.4 million of gain last year for the sale of Tex-Mex to TFM in the first quarter of 2002. All in all, KCS earned about 4.7 million down from 9 million on an adjusted basis from the prior year.

Next slide is the pictorial of how we got from 2002 to 2003, in terms of operating profit, I guess again the highlights here, we had good cost controls in a very tough environment, we want you to note the minor increases in labor costs that Mike and Gerald have highlighted, improved equipment utilization from MCS, that gave us a very major upside benefit for the quarter and a disciplined approach on purchasing and cap ex kept us in line on that side. Higher fuel costs and the loss of the coal contract really are the bullet points of the pain that was suffered in the 1st quarter here, ending up at \$6.8 million for the quarter.

On the next slide, it is just for informational purposes, I think Gerald explained quite efficiently the benefits we did get from hedging. Going forward this quarter, we're 40% hedged, 21% hedged going into Q3 and 16% hedged in Q4. Our price for the quarter was about 90 cents a gallon and that compares unfavorably with 63 cents a gallon the prior year.

On the next slide I want to emphasize -- I guess this is some of the pleasing aspects of our report this quarter, even in a difficult operating environment in this 1st quarter, our credit measures continue to improve. The debt reduction program began following the 3rd quarter of 2001 continued with focusing on monetizing surplus assets, accelerating collections, basic blocking impacts and running the business. We've held off paying off debt in view of the proposed transaction, and our cash balances are now at the end of March, are \$64 million.

A brief word about debt to total cap ratio, there has been some commentary about NAFTA Rail's future debt to total cap post consummation. Our preliminary efforts on a proforma consolidation, pre-acquisition financing utilizing 12/31/2002, is nowhere near close to the 70% numbers. TFM results for the quarter were impacted heavily by the devaluation in two ways, one is on the operating side they were impacted not only in person on materials and goods, but also that the revenue line was impacted heavily by the paying customers about \$13 million year over year. The operating ratio for the company on a U.S. cap basis was 83.5%, given this economic environment, is still comparable with that experienced by all the North American railroads this year.

Finally, a brief note about the preferred taxes, once again KCS has benefited from the inflation rates in Mexico, which are running at a 4.5% per annum basis right now, and the peso exchange rate is about 10.8 for the quarter, though it has strengthened in the last couple weeks, it's now at about 10.37 pesos to the U.S. dollar. All in, for the first quarter, the net benefit deferred taxes from

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the devaluation of the peso and inflation was \$6.7 million.

In terms of guidance the quarter, we are cautious in our view for the 2nd quarter and are monitoring the situation. But as usual, we are caveated that TFM's numbers are a bit of a wild card given the swings created by the peso and inflation on the deferred tax line.

We are cautiously optimistic about the 2nd half, with FCS fully imbedded and with good cost controls in the system, and with new movements of traffic coming online, there is potential to see improvement in our U.S. operations in the second half. With that, I'll throw it over to Mike.

Michael Haverly, Kansas City Southern - Chairman President and Chief Executive Officer [5]

Well, now, we'll turn to the second part of our presentation, and one of the things I forgot to do at the beginning of the first presentation was read the safe harbor message that I'm supposed to read at both of these, so I'll just combine the safe harbor for both.

These presentations include statements concerning potential future events involving the company which could materially differ from events that actually occur. The difference could be caused by a number of factors, including those factors identified in a current report of form 8K dated 12/11/ 2000, one filed by the company with the S.E.C., file number 1-4717. The company will not update any forward looking statements in the presentation to reflect future events or developments.

This presentation will cover our NAFTA Rail transaction. I will obviously be a speaker, Ron Russ will also cover part of this, and a little bit later in the program, we are going to ask Jim Jones, who is the former U.S. Ambassador to Mexico and a member of the Kansas City Southern Board to join us on the telephone from Mexico at the end of the presentation to give us his view on where we stand on the value added tax dispute that is ongoing in Mexico. So, he'll be on in just a few minutes.

Before I get started talking about the transaction, let me just say that we view this as a very, very exciting transaction, not only Kansas City Southern, but also for TMM. We cannot think of any strategic move that we could make at this point in time that would create more value for both the Kansas City Southern shareholders and the TMM shareholders. We have had a vision of a NAFTA Rail system for many, many years, and this is an opportunity to put this system together.

And as you hear in the presentation, you will understand that Mexico is clearly the greatest revenue producing opportunity in North America. It's proven to be that in the past, and we believe it's proved to be that in the future. We want to capitalize on that opportunity for both the shareholders of Kansas City Southern and TMM.

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So, as we talk about the transaction, first of all, I think everyone understands that NAFTA Rail will replace the holding company name of Kansas City Southern. NAFTA Rail will purchase from group-O TMM 38.8% their ownership of TMM. In exchange for that, NAFTA rail will give to group OTMM 18 billion shares of NAFTA Rail stock, \$200 million in cash, plus, there's a potential incentive payment for TMM for \$100 to \$180 million dollars based on a favorable resolution of the tax dispute that is ongoing at this point in time in Mexico. And then, we will immediately pay to TFM \$32.7 million for its 51% of MEX-Rail, and we will put that in a blind trust pending approval of the Surface Transportation Board in the United States.

You cannot commonly control two railroads in the United States without Surface Transportation Board's approval, but we will move quickly to carry this transaction out and we will put in a blind trust. The structure of the company's next bill is pretty simple, as I said, NAFTA Rail will replace the Kansas City Southern Holding Company, and it will own all of Kansas City Southern Railway, it will own all of Tex-Mex Railway, and it will own about 86%, excuse me, 76% of TFM, the Mexican Government still owns about 24%. You can look at the map here and see Kansas City Southern and Tex-Mex and TFM on the map, and you can understand how they link together on an end-to-end-to-end type configuration.

We will keep the railroads independent, and the reason that we want to keep the companies independent is that we respect the rights of TFM to operate in Mexico, with Mexican employees and Mexican management manage the company on a day-to-day basis. The holding company will provide guidance, clearly on marketing aspects and utilization, financial advice, information technology and so on, but we understand that because of cultural differences and language differences it's important that we not try to put these companies together.

We also respect the historical significance of the Texas Mexican Railway that's been headquartered in Texas for well over 100 years, and we will keep that company independent and, of course, Kansas City Southern, that's been around since 1887 will be independent, but the entire network will work together as a single network cooperating very closely together.

The corporate governance and management of the company, I will be the Chairman of NAFTA Rail, Pepe Serrano, TFM, will be the Vice Chairman, and he will continue to be the Chairman of the TFM. The seven current Kansas City Southern Board members will be on the new NAFTA Rail board and also joining the Board will be the President of TMM, Javier Segovias. I will also be President and CEO of NAFTA Rail and at least for the time being, President and CEO of Kansas City Southern Railway, managed by TFM, Mario Mohar, who has been the CEO since the start of the company, will continue to be President and CEO of TFM.

The next slide, the strategic rationale for why we are doing what we're doing. Clearly, it is to enhance shareholder value by achieving consolidation of the rapidly expanding TFM affiliate in Mexico with the U.S. ownership. Not only do we have the growth in Mexico, but also, the opportunity to flow more traffic over the combined system which is going to add to the value of the new company.

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Also, we've got an increase in earnings per share that will result with the faster growing rail operations in Mexico, and I think it's important to understand -- and Ron will talk about this a little more, that this transaction is accretive from day one. It's a good move for our shareholders. Also, we intend to improve the Tex-Mex infrastructure and operations, that is the critical link between Kansas City Southern and TFM, we will work on that to improve that.

We want to strengthen the three railroads as the NAFTA railroads, we referred to ourselves for some time as the NAFTA railroads, we want to give the shippers that as they use the NAFTA trade corridor, a stronger transportation alternative, we'll be better as a single company, stronger as a single company than we were as three independent companies. And then also we are looking to lengthen the haul through across the border view. Instead of looking from Meridian to Beaumont and from Beaumont to Laredo, we'll be looking from Mexico City to Meridian, and Mexico City to Kansas City and different connections on the Kansas City Southern that lengthen the haul of as much traffic and improve service as we can through competitive service and rates.

Next, as we look at what it's going to take to complete the transaction, bank group consent to consummated, we announced last night that we have gotten that consent from our bank group, headed by J.P. Morgan and the approval was 93%. We also need the approval of TMM bond holders, we need approval of the share holders of both Kansas City Southern and TMM. In order to control two U.S. railroads as I said earlier, Tex-Mex and KCS, we have to have the U.S Surface Transportation Board Approval. Tex-Mex is a class II railroad, Kansas City Southern is a class I.

Ordinarily a transaction like this would not be considered a significant transaction. Clearly the transaction is end-to-end. There are no points on the railroad where you're going to go from two competitors to one, or even three competitors to two. It's clearly end to end and there's no overlap at all. So we feel that this will be approved and we hope that it's approved in an expedited manner.

We also need the approval of Mexico's competition commission. That's kind of like, as you may view in the United States, the Antitrust Division of the Department of Justice. And again, we don't see any competitive problems here. We think if anything, this will strengthen competition for Mexico so that there's not as much dominance as there is today.

Mexico's Foreign Investment Commission must also approve it under Mexican law, Mexican Company or Mexican National has to own controlling interest of the company, but over the last few years, there have been waivers to that law that have been pretty consistently given, Citibank taking over BaniMex is probably one of the primary examples, and there are many others, telecom companies taking control. There's several examples and we don't see a problem with this, ~~there~~ will still be 20% voting control in the hands of a Mexican company, and you'll have additional ownership beyond that, so there's going to be a significant

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position by Mexican shareholders in this company, and we intend to, as I say, operate TFM independently, so we don't see that this will be a major problem.

Next slide, why are we so excited about this opportunity, well, we were excited when we invested in Mexico back in 1997. We saw the opportunity for NAFTA coming, and it was not nearly as clear in 1996 as it was today. This shows that the U.S. trade with Mexico exceeds \$260 billion a year. It's four times what it was 10 years ago. Seventy-seven percent of the trade of Mexico goes to the United States and a few weeks ago if it's in Mexico, with a small meeting of businessmen with President Fox, and he talked about how Mexico purchases more from the United States than from England, France, Germany, Italy and Spain combined and Mexico will surpass Canada as the number one U.S. trade partner in the next eight years if we follow the current trends.

Eighty-five percent of Mexico's imports from the U.S. today are manufactured goods, in the past, that was primarily petroleum products and agricultural products. Now you have automobiles and many other types of manufacturing that is done, you have steel and so on moving into the United States, and Mexico is also developing from a low-cost assembly manufacturing area to a value added manufacturing area.

In the past I think some people looked at Mexico as just a low cost manufacturing point. I have talked to representatives of all three of the U.S. manufacturers of automobiles and they tell us that not only are their lowest cost vehicles produced in their entire worldwide network in Mexico, but also their highest quality, Mexican workers do an outstanding job, so it has a value-added aspect to it. Also, we think that Mexico is positioned because of its geographic location and its far-reaching free trade agreements could be an international manufacturing hub, not only from North America to the western hemisphere, but also for the world.

So, anybody that thinks that NAFTA has not been successful only needs to look at some of these numbers, and when you think about the opportunities going forward, this is a great railroad transportation opportunity and that is why we forward, this is a great railroad transportation opportunity and that is why we want to put these three companies together.

Now, do we have to go down to the United States, excuse me, down to Mexico and improve the railroads? No, that has already been done, since 1996 really we started operating in '97 although we began preparing for capital improvements as far back as 1996, we have put into the Mexican railroad all the things that you will find in the United States, centralized traffic control, the communication systems, the technology where we detect defects along the track, smaller crews, like you find in the United States, and so on.

In addition to that, the main railroad routes have been improved, we have installed welded rail, we have improved the car capacity over the Laredo bridge by three times by better operating practices, there have been over 150 new locomotives purchase for that railroad, 75 from G.E. and 75 from E.M.B., we put in new capacity and siding, there are 7 intermodal facilities down there to

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date, 5 of which are brand new and 70 transload facilities with 12 new facilities planned.

The next slide, if you just look at the revenue growth and just for clarification, '97 was only a five month period of when we took the railroad over, but you can see the kind of revenue growth and clearly there has been some of the flattening from 2000 through 2002, but that is because, again the U.S. economy has been sluggish and as a result of that, I showed you what the trade is between the two countries which clearly is going to affect Mexico.

But, if you look at the next slide, and you look at the revenue increases that have been enjoyed by the Mexican railroad compared to all of the U.S. class one railroads combined, between 1998 and 2000, clearly, TFM is the fastest growing revenue opportunity in North America.

The next slide shows what Kansas City Southern's growth has been since the investment back in 1997 in terms of the volume of traffic that is moving between Mexico and the United States and in the first quarter of this year we have experienced a 17% increase in the number of units going to or from Mexico compared to last year and obviously, when the three railroads are put together, we expect that number to go up substantially as we put more focus on taking advantage of better service and a better opportunity for single pricing from Mexico to the United States and vice versa, that will increase substantially.

The next slide, from an operations and marketing perspective, the three railroad companies will connect end to end so what we will do is design a system that looks not at the three individually, but we will schedule trains from origin to destination from Mexico to the United States and from the United States to Mexico. We will use a common computer system, our MCS system that we are planning on putting on Tex-Mex in September and then 1st quarter of next year, Mexico, and we will closely watch the movement across the border, we think we can improve that, we have already made a lot of improvement.

It will be seamless service, as I said, from Mexico to the heartland of the United States, we will have a common transportation service plan and schedules in place for cars that go from one country to another. The integrated customer service will be easier for customers to communicate with all companies in both countries and we will have through rates between Mexico and the United States and the United States to Mexico that will be easier for customers to understand. And you can see here that the combined resources will be much greater, 965 locomotives, 25,000 cars, and you can see some of the other things, also, we will have about \$1.3 billion in revenues which will make this company a stronger company.

True, we are still going to be the smallest company but we are going to have a lot of influence of traffic that moves between Mexico and the United States and we will certainly improve our financial situation longer term and continue to build our revenue base and become stronger per long term.

Now, TFM recently did a study in Mexico with 200 customers, 134 are those that

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represented 70% of their current volume in revenue and then 66 potential customers and as you can see here, existing customers identified potential shift in business to TFM that could add as much as 40% to TFM's total volume over the next two years and the potential customers, the 66 identified conversion potentials that would add nearly 10% to TFM. And most of that, as you can see here in this pie chart, comes from trucking, about 73% of the total traffic, I think, shows that it would come from trucking.

Some of those that have been invested in us for some time or in TMM or TFM or KCS bonds may remember that we talked about the opportunities to convert from truck to rail at the time when we made the investment back in 1997. At that time, the railroad had gone down to 11% of the inner city market in Mexico and today, we are up at around 15 or 16%, but our objective was to get back to only 20%, if we felt we could get back to 20% of the inner city market we could justify our investment.

Well, as it's turned out, we have really justified our investment with far less market share and we have not converted over the last five years as much intermodal traffic from truck to rail as we had anticipated because what we did is concentrated on traditional rail traffic such as automobiles, auto parts, grains, steel, cement, appliances and different things. We intend to concentrate much more so on intermodal in the future and we are going to be able to provide certainly truck competitive service, we have got 7 intermodal facilities now, 5 of them are almost brand new and that is going to give us the opportunity to move forward in this truck conversion.

So, this map here just shows the location of these intermodal facilities, and as I said, 5 of those are brand new, if you look at the next map then, you can see how Kansas City Southern fits into the entire rail network in North America and I think you can see where Kansas City Southern, soon to be NAFTA Rail, will fit into the North American scheme.

So, from a strategic standpoint, this combined company could not be better positioned than it is right now, and I think all of us have recognized for a long time that the crown jewel system in Mexico has been Laredo to Mexico City. With that, I am now going to turn the call over to Ron Russ, and then we are going to ask Ambassador Jones to come on the phone here.

Ronald Russ, Kansas City Southern - Executive Vice President and Chief
Financial Officer [6]

Thanks again, Mike. I just want to take a moment to expand on a few points we made last week on our conference call and also bring everyone up to speed on where we are.

As Mike mentioned earlier, I want to focus a bit more on the process and approvals needed to complete the transaction. Mike showed a slide earlier of the approvals and the key constituents, now let us address each one in more detail. First, you saw our announcement last night, we have made good progress with our

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banks. The bank group has consented to consummate the transaction, to acquire group-O TFM shares and to our consent to acquire 51% of Mex-Rail shares. By the way, that approval was at 93% of our bank group.

The bank group also consented to the use of KCS cash on hand to acquire the 51% interest in Mex-Rail for \$32.7 million. Again, cash on hand at the end of the quarter, \$64 million, up from 19 at the end of the year.

After other approval, let's take a look at TMM bond holders. Their F-4 has been amended and that went effective yesterday, the offer is to exchange their notes due on May 15, 2003 and in 2006. The new notes maturity is May 15, 2004, there is a interest rate coupon improvement to 12% per annum, and the exchange offer expires on May 12th of this year. Both groups of shareholders need to approve the transaction and we will be moving forward with that shortly, we expect that to take place within the next 90 days.

From a regulatory perspective, the U.S. Surface Transportation Board gets involved with the Mex-Rail transaction. NAFTA Rail acquired 51% for \$32.7 million, the Mex-Rail shares will be placed in a voting trust while the S.T.D. reviews the application for common control. The application will be filed shortly, and we consider it to be a minor transaction.

Mexico's regulators will also review the transaction, first, Mexico's Competition Commission. We believe that common control of the three railroads is pro-competitive. The estimated time line for the approval is within 120 days.

Mexico's Foreign Investment Commission will also review the transaction. Again, as Mike said earlier, we believe that there are precedents in the marketplace Citibank Group and BaniMex, Anheuser Busch and Modelo, Wal-Mart, et cetera, just to name a few. Again, the estimated time line there, we anticipate this to be completed within 120 days.

Now let's spend a few moments talking about VAT, keep in mind that we view VAT and the VAT lawsuit as an asset even before the magistrate's court decision. TFM filed this suit in 1997 alleging that the government failed to make a value added tax refund to the tune of \$206 million. On October 11th of this past year, the Mexican magistrate's court unanimously ruled in the favor of TFM and ordered the lower fiscal court to issue a new ruling consistent with their decision. On October 10th, the lower fiscal court issued a ruling denying TFM the right to receive that refund. TFM has appealed the October 10th ruling on January 29, 2003

With respect to the government, a lot happens before they turn to us. First, there is the decision to proceed with the public quote and that decision takes place prior to October 31, 2003. Second, the 20% interest is put to first group-O TFM, they will have 60 days in which to make a decision. Finally, the 20% interest, if group-O TFM decides not to take up on the put is then put to NAFTA Rail, ie. Kansas City Southern and group-O TMM, the time frame for this is January to February 2004.

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Again, this is the end of February, it is nine months but the primary objective of this transaction is to close first, to better deal with the put on a rolled up basis. As perspective, we think about the VAT put issue in the context of probabilities. First, we believe that the probability of VAT being equal to or greater than the put is high based on the high court's decision of this past fall.

Second, no event recovery is a very remote probability, third, we believe Mexico will not execute the put without knowing the resolution of the VAT dispute. It just makes basic common sense, you are looking at \$485 million not knowing if you have a potential obligation downstream of better than \$800 million.

Now let's turn to the transaction details and financing, first let's spend a moment on the consideration to be paid. The consideration paid for group-O TMM for group o-TFM shares is 18 million shares of NAFTA rail plus \$200 million cash. Or at NAFTA Rail's option, NAFTA Rail could pay \$120 million cash, plus \$80 million worth of NAFTA Rail's shares, approximately 6.4 million shares in total. Finally, the separate transaction of 51% of Mex-Rail for \$32.7 million.

Now, let's talk about where we are, at least \$120 million is the consideration we're focused on. We're very confident this will be done very quickly. The bank group has consented, we believe \$120 million will be raised. You have seen these pages before on the next slides. I just wanted to give everyone a sense of the financial scale of the combined entity.

No VAT, no put case is a very conservative case. The valuation portrayed on this next slide is based on yesterday's close, a valuation of \$406 million. Again the multiples, 2.9 times the revenue, 7.9 times EBITDA, and 11.6 times of EBIT, that's the lowest multiple that's been seen in any transaction except for th BNCN, a deal that never went through.

In terms of earnings impact, again, this slide displays our view, that is it's accretive from day one, even if it is entirely equity financed. It's again, the lowest multiple paid for any major rail transaction in recent history that's been concluded, and accretive even without synergy even when financed with all equities

We're very excited about this proposition. I'm excited about the opportunity of getting \$360 million of EBIDTA. In that regard I'll throw it over to Mike Haverty.

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [7]

Before we entertain questions here, I'd like to ask if Ambassador Jim Jones is on the telephone and could maybe give us his views on the value added tax dispute in Mexico. Are you there, Jim?

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Jim Jones, Manatt Phelps and Phillips - Board Member [8]

Yeah, I'm here, Mike. I'm here in Mexico city at another meeting, but I heard most of your presentation -- recently on the value added tax issue, perhaps everyone there is familiar with it, very briefly, and simply, this is a question as to who issued the valued tax refund. Who filed for that refund, who was entitled to file for that refund even who received that refund back in 1997, which at that time was roughly -- a little over \$200 million.

When TFM brought its case before the fiscal court, which is called the tax court also, the tax court is, to put it in context, is a division of the ministry of finance. To speak anecdotally, when U.S. firms had some difficulties before the tax quarter or disputes on tax issues and it came to us for some assistance, I found that the tax court, without exception, ruled on what the ministry of finance position was and, if justice was to be done, it was done at the appellate level. That's where the appellate court overruled the tax court, and remanded it back to the tax court with the instruction to vacate its prior judgment, to weigh the evidence again and issue a new ruling that is consistent with the appellate court's interpretation.

In January of this year, when TFM was notified that the tax court again ruled against it, it appears that most of that decision or that opinion was based on an article in a new law. A new fiscal code that was passed by the Mexican Congress in 2001, four years after this event was in dispute. And so when TFM appealed again at the end of January of this year to the appellate court, it cited several violations of TFM's protection under the Mexican constitution. I might add the case is in front of the same panel that saw the case before and it seems the same lead judge is in charge of the case.

Now, in trying to predict what's going to happen, it's even more difficult in a Latin country that has the civil code because it's substantially different from the English common law. It's hard to tell what the decision is going to be made because the concept of legal precedence that we have in English common law is not the same.

However, having said that, we first look to the attorneys that are representing TFM and how they look at the case, and particularly relying on Dr. Herbert Bettincourt, who is the lead attorney for TFM and one of the most respected constitutional lawyers in Mexico, from the beginning of filing this case a few years ago, he has been very confident on the outcome, based upon the constitutional protections for TFM. And short enough, on appeal, he was proven correct.

The attorneys are still very, very positive about the outcome of the case, and as you know, under NAFTA, there's been several reforms, political and economic reforms and the legal and judicial reforms are in the process of taking place. But particularly, at the appellate levels of the Mexican judicial system, the quality and transparency of the judges and the decision has significantly improved.

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So I would agree with Ron, that based upon the constitutional basis, that the TFM should be able to prevail on the law and on the constitution. Now, what will that mean in terms of dollar amount? Well, the original claim was for 200-plus million dollars, and then when you add the interest and the other items, it could be in the 8-900 million range, but clearly, by almost any measure, you would believe that it would be equal to or in excess of the value added tax refund.

With the put not having to be exercised for clearly until February of next year -- I think that those two events clearly can take place. Then the question is, of how that refund will be applied. Will it be applied to pay for the put or in what other manner. And that is how I see the case now and as I say, I think we're quite positive on the outcome. Thank you very much, Ambassador and thank you for joining us from Mexico..

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [9]

With that, we will open it up to questions here in the room here in New York. This young lady right here. First of all, I think we need to, Bill, individually identify themselves and the company that they're with over one of these microphones.

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Questions and Answers

Jennifer Ritter, Lehman Brothers [1]

Jennifer Ritter with Lehman Brothers, a couple questions on Mexico. First in the quarter, first quarter results, did I hear you say, Ron, that if we -- there was \$13 million kind of delta due to the peso devaluation, if we were to try to get an apples to apples comparison, we would add \$13 million to the Mexican, or to TFM's revenue?

Ronald Russ, Kansas City Southern - Executive Vice President and Chief Financial Officer [2]

That's correct, Jennifer, the peso devaluation has impacted the Mexican peso customer base, paying base, which is something in the order of 47% of the customer base of TFM and that was the order of \$13 million year-over-year in the 1st quarter.

Jennifer Ritter, Lehman Brothers [3]

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So revenues, in fact, did grow in TFM?

Ronald Russ, Kansas City Southern - Executive Vice President and Chief
Financial Officer [4]

Yes, that's correct.

Jennifer Ritter, Lehman Brothers [5]

And then just to be ultra clear on the put and how it works, the second step is 20% interest put to group OTFM, they can refuse to make good on that put and then it goes to KSU and GTMM?

Ronald Russ, Kansas City Southern - Executive Vice President and Chief
Financial Officer [6]

That's correct, that is the original bargain and how it was structured. If the group OTFM passes, then it goes to the two consortium partners in the original concession, Group OTMM and Kansas City Southern. Their obligations are joining several, if one of the partners declines under the old arrangement, the entire obligation fell on the other partner. In this instance, the rollup of the three companies, NAFTA Rail, it will become the payer of that put.

Jennifer Ritter, Lehman Brothers [7]

So really, because NAFTA Rail is going to earn 95% of group OTFM. You're making the decision for group OTFM as well in many ways?

Ronald Russ, Kansas City Southern - Executive Vice President and Chief
Financial Officer [8]

To be clear, if we were to acquire the interest in the put, there would still be that interest or group OTFM held by its subsidiary, TFM. So there still would be residual interest, but we would be control of the situation, and we would more than likely influence the way the decision was made.

Jennifer Ritter, Lehman Brothers [9]

Thanks for your time.

Michael Haverly, Kansas City Southern - Chairman President and Chief Executive
Officer [10]

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I think I may follow-up on that, the importance of what Ron has talked about, and the question you asked, Jennifer, is I think there's been kind of a misconception in the financing of this transaction that we raised the \$200 million, and then "bang" all of a sudden, we have to come up with \$500 million.

The fact is, as Ron as pointed out, you have until next February to come up with this. The VAT is still outstanding and does the Mexican government really want to exercise the put with this issue that's still outstanding. And I think that's an important issue.

So, anybody that has the misconception that is like "bang bang" we really have to raise \$700 million right away, that's not the case. We're taking it one step at a time. The 200 million first of which we already targeted really, the number is 120 that we have to raise, we can use stock for the other 80 million if we need to. The cash needs are not there hitting us in the face immediately. Next question, Tom?

Tom Waterditz, Bear Stearns [11]

Hi, it's Tom Waterditz from Bear Stearns. I have one question for you, Michael and two for Jim. Can you give us a sense of your view of how much political influence there is on this foreign investment commission, how much room there is for I guess meddling from other parties that might want to cause trouble. Just your opinion on that?

Michael Haverly, Kansas City Southern - Chairman President and Chief Executive Officer [12]

Jim, are you still on here? He may have had to go, he was actually down there for an Anheuser-Busch board meeting, and he may have had to go.

You know, I certainly don't have the expertise on that, I think our partner in Mexico has a lot of experience with that, and we depend upon his advice and I think what we can say best here, Tom, is that we have found the competition commission to be very fair, and not to be politically motivated. They look at a situation, and this is what our partners told us, and they determined whether or not they think it is competitive or anti-competitive, and they rule accordingly, and that it is not greatly politically influenced.

Tom Waterditz, Bear Stearns [13]

Okay. Maybe if I can -- two more for you, Michael, one of the opportunities seems to be taking some of the traffic away at Laredo that goes to either primarily UP, but also to Burlington, I guess Burlington would be through El Paso or Eagle Pass.

But to get some of that business, can you give us a sense of how you're going

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to do that, given that UP does have a route structure advantage to say Chicago or other places, and maybe the magnitude of the revenue that you really think you can take from other railroads?

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [14]

Let me clarify one thing. B&S does not go to Laredo and TFM does not go to El Paso. Where TFM interchanges with B&S is at Brownsville, which goes across the border point, and then also at Robbs town, which is located on Tex-Mex at the east end near Corpus Christi, and then UP operates at Laredo, but clearly UP is the dominant carrier through Laredo, and that's why we think that this offers one of the opportunities for shippers to look at more equally of spreading traffic between competitors and I know the railroad business well. We clearly are a competitor in certain markets with the UP.

I can give you an example of -- we were handling Volkswagen automobiles going to Nova Scotia, and competing with the UP in and transit time via Canadian national through Jackson was four days faster, so there are ways you can structure trains, schedules, planning and so on that can make our system competitive.

Are we going to close the gateways at Laredo and Brownsville? Absolutely not. Are UP and B&S, that's still going to be important connections, and U.S. partners for TFM, we plan for that to happen. And what we think is that over time with the new service that we can provide, when it's much more competitive, that we could draw more traffic to the combined system. And we will add more focus on pricing over the combined system.

But does that mean that we're going to take everybody else's business? Absolutely not. That's not going to happen. And I'm not going to identify at this point in time just exactly what the revenue synergies are, because what we've done is we've based this transaction not looking at synergies, and we are saying that it's accretive without synergies.

Tom Waterditz, Bear Stearns [15]

Second question? If I can sneak one last one in here. Can you give us a sense of what the basket is right now in terms of what can be paid dividends from TFM and over what time horizon do you think you can really begin to meaningfully exact cash, because they have a great operating ratio, great tax dividends, do you think at some point you could have a cash payout out of that or pay down debt?

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [16]

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I think right now it's pretty premature to think in dividends. Our number one objective is going to be to pay debt down in Mexico. And also, to make capital investments and remember, you can also put capital investments into equipment, and equipment can flow between the different systems, we're a long way, I think, away from worrying about extracting cash out of Mexico.

I have one other thing I might add that I don't think Ron touched on this, but one of the advantages, we think, of rolling these companies together is then having it as a U.S.-based company, as we go to the markets out here, debt markets and so on, that we think we can have a better opportunity to get some better financing opportunities and strengthen the balance sheet and recapitalize longer term, and that's one of the things that we're going to be clearly focusing on, but we did not intend to be paying any dividends or taking any cash out. We're going to be focusing on debt reduction.

Tom Waterditz, Bear Stearns [17]

Congratulations on the transaction, thanks for the time.

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [18]

Thank you.

Orlando Mushan, Great T Capital [19]

Orlando Mushan Great T Capital, how long do you think it will take you to have financing in place, and are you looking at a bond issue or are you going to borrow more from the banks?

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [20]

Okay. Ron, I'm going to let you answer that question.

Ronald Russ, Kansas City Southern - Executive Vice President and Chief Financial Officer [21]

Yeah, thanks, Mike. We're right now in the process of working with our financial advisers, we expect a very near term resolution on this, with the door opening with the consensus yesterday, that gave us the ability to conclude a transaction. So we'll be working with our financial advisers and coming up with a near term plan shortly.

As to the type of instrument, capital raising, we're going to follow right now,

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I'm not at liberty to say. We thought in the past of debt and equity, and we're pursuing both of those.

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [22]

I might also comment that one of the things we've seen in -- from the publications is that KCS has a 70 debt total cap ratio. And we're not sure where that number comes from, if you look at without leases it's 43% with leases it's been about 58.

If you combined the two systems and took all the debt and equity and figured this out between the two companies, it still comes out to about 58, so we're not sure where the 70 was calculated, but that's a number that keeps showing up. In many publications, and that's where I think people think this company is going to be 70% leveraged, and that's not the case.

Orlando Mushan, Great T Capital [23]

And the second question is regarding the VAT ruling. Is this going to be a final ruling, or can the decision be appealed? And let's say that instead of getting cash, you get to offset the put from the government, does TMM still get an incentive payment or not?

Ronald Russ, Kansas City Southern - Executive Vice President and Chief Financial Officer [24]

I can answer that, Mike.

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [25]

Okay.

Ronald Russ, Kansas City Southern - Executive Vice President and Chief Financial Officer [26]

First off, in terms of the appeal, it is our understanding from our legal advisers that this will be a final decision. It more than likely will be directed to the governments to pay the certificate -- to give the certificate directly to TFM.

Your second part of this question was with regards to, I believe, the incentive payments to TMM. Those incentive payments are not payable unless the VAT is

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equal to the put. And that begins the mechanism of payment output to TMM.

Orlando Mushan, Great T Capital [27]

What if the payment is not in cash?

Ronald Russ, Kansas City Southern - Executive Vice President and Chief
Financial Officer [28]

It is my -- our understanding from our financial -- our legal advisers in Mexico, that if the certificate is received, we have to hold it, and there's been discussion whether we hold it for 60 days or six months, there's some interesting discussion on that, but leave it to be said, once received in hand, it's held and not utilized for payment of taxes, it converts to cash in the six month or sixty day time frame. That's what generates the cash, which we hope is logically offset to the put, and potentially funds to TFM.

Arthur Shield, Roosevelt Investment Group [29]

Yes, Arthur Shield, Roosevelt Investment Group. First of all, congratulations, I think it's a terrific transaction. Three short questions, if I can, first one, is the amount in question on the VAT, in other words, if, in fact, you win, do you win the full amount, including interest and so on, or is that a separate issue that will be addressed?

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [30]

I think I can probably address that, the legal counsel that we have in Mexico says that you go back to 1997 when this was first filed and then the value of the VAT at that time was \$206 million. And then overtime, this escalates, I think as Ambassador Jones said, that we calculate that value today to be somewhere between 800 and \$900 million.

Now, the value of the put, I think last time we looked was about \$485 million based on the value of the peso at that time. So, you know, do you end up settling it and getting cash, or do you end up settling it and getting a wash on the settlement. Or just how it works out if that is what works out, we'll see.

But the thing that we're concentrating on at this point in time is the legal process, and the VAT decision. And that's what I think Ambassador Jones was saying that based on his indication, that hopefully in the next 60 days we would have a decision that would come out of Mexico.

Arthur Shield, Roosevelt Investment Group [31]

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Okay. And two related questions, looking at your bullet points on the approval process, did I understand it correctly that the TMM bond holders could negate this transaction?

Ronald Russ, Kansas City Southern - Executive Vice President and Chief Financial Officer [32]

That is correct. They do have the ability to not want to exchange their notes. We believe that they now have incentive to be paid in full as a result of the transaction entered between KCS and Group-O TMM. So we're very confident that they will look at TMM being in the position of receiving \$200 million in consideration immediately, and being able to use that to take care of their obligations.

Arthur Shield, Roosevelt Investment Group [33]

Thank you. And finally, is the number of shares that TMM will get in this transaction with the stand still agreement, or could they, if they had the wherewithal, buy more stock?

Michael Haverty, Kansas City Southern - Chairman President and Chief Executive Officer [34]

There is a -- if you heard the conference call a week ago, Pepi Serrano was on and talked a bit about the stand still, I will just go over that again, there was a stand still for about six months, at which time he is freed, but he has to sell his shares in a prescribed fashion. TMM has entered into a registration statement which will allow for various disbursements into the public marketplace overtime. He is constrained from selling the controlling block to any interest of strategic or investment -- potential financial investors. Any more questions? Okay, it lasted a little longer than we anticipated. Thank you very much for joining us today. Thank you.

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NAFTA RAILWAY



KANSAS CITY SOUTHERN

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March 5, 2002

Despacho Previo Process Clarified

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KCS with its partners, TM and TFM are second to none in servicing markets in Mexico. At times, the process of clearing southbound cars at the border is confusing. However, as representatives of the NAFTA Railway, it is important for KCS employees to understand this process, which is known as, "despacho previo".

From a transportation standpoint, despacho previo serves two main functions. The first is to notify the broker when cars are billed to Mexico. The second is to release the cars for movement into Mexico when all paperwork between the forwarder, broker and customs is complete. For KCS, notification to the broker begins when a car is billed for movement to Mexico, regardless of origin carrier. When TM receives the waybill transmission, an email notification or "despacho previo notice" is automatically generated to the broker (freight forwarder). This notification begins a flow of paperwork, which when done properly, ensures the car will move transborder without delay.

The following steps occur when pre-clearing a railroad car moving from the U.S. into Mexico:

1. The origin shipper documents the car with the origin railroad carrier and provides the information to the U.S. freight forwarder.
2. The U.S. railroad at the border issues a despacho previo notice.
3. The U.S. freight forwarder furnishes the necessary documentation for an export movement into Mexico (including copies of the waybill) to the Mexican Customs broker.
4. The customer establishes how export duties or other dues will be paid with the U.S. freight forwarder. The Mexican Customs broker pays the import duties.
5. The Mexican Customs broker pre-documents the shipment with Mexican Customs.
6. The Mexican Customs broker pre-documents the shipment with TFM.
7. The Mexican Customs broker delivers the pre-filed documentation to the U.S. freight forwarder.
8. The U.S. freight forwarder delivers copies of all documents to the U.S. connecting railroad at the border, and pays any document delay or demurrage/per diem, if applicable.
9. Finally, the U.S. railroad pre-notifies the car to cross into Mexico.

With despacho previo, cars cross into Mexico for final delivery without being detained at the border. The exception to this process is when Mexican authorities (Hacienda = Treasury) randomly check cars at Nuevo Laredo. Once the car is cleared for Mexico and TM receives the necessary information from the forwarder, a release is entered into their computer system, which automatically updates the KCS system and allows KCS operating personnel to move the car to Mexico.

While the steps for clearing a car into Mexico are clearly defined, the process can be delayed when documents and payments are not received in a timely manner. Long ago, KCS determined that it would not allow uncleared cars to move to TM, so KCS holds all uncleared cars at its Beaumont Yard. This is to prevent congestion on TM, to promote the free flow of traffic to and from the border, and to facilitate the movement of cars held for document delay. KCS has the ability to switch cars from a hold track and to move them toward Mexico within 24 hours after release. Cars delayed at Beaumont are almost always delayed due to clearance problems.

KCS offers a number of other services of which customers may not be aware. Unlike other railroads, KCS and TM offer free time of 72 hours, or the time needed for the car to reach Beaumont, depending on which is greater. Since KCS generates notification at the time of billing, this can add many days free time to the clearance process. KCS' Customer Service Center also proactively monitors the cars being held for clearance into Mexico and will even

provide interface between the shipper and forwarder to ensure paperwork problems are held to a minimum.
Document delay charges on TM are significantly less than other railroads.

An upcoming issue of the *KCS News* will outline the process for moving cars northbound from Mexico to the United States and the Automated Manifest System, which was implemented in 2001.

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July 9, 2002

NAFTA Railway Partners Reflect and Pursue New Opportunities

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On July 28th, NAFTA Railway alliance partners KCS, TFM and Tex Mex met in Houston for a quarterly meeting to pursue new opportunities for NAFTA Railway growth. Operating, marketing and customer service representatives were present to discuss, among other topics, freight traffic opportunities both north and southbound. All partners agreed that there are tremendous opportunities to grow the business and improve service, especially in conjunction with the recent alliance with BNSF, as well as more established alliances such as those with CN, NS and IMRL.

Recently, the synergies of the three partners have again proven successful with the operational improvements seen on Tex Mex since March. The three groups reported on efficiencies already in effect, such as the consolidation of KCS and Tex Mex dispatching, crew calling and timekeeping to KCS' System Transportation Center in Shreveport.

Since the consolidation, customer service representatives from all three partners, talk weekly about the joint operation. "The team has developed a seamless, one-stop customer service approach for moving traffic in and out of Mexico on the NAFTA Railway," said Jan McNeal, KCS' AVP customer service. "Each week, the team covers service performance related to KCS' new pre-blocking plan for traffic going southbound into Mexico, despacho previo and clearances that will help expedite traffic, technology updates such as Electronic Data Interchange (EDI) performance and billing, as well as current customer issues. The team will continue to resolve issues and provide regular updates to senior leadership."

Since the meeting, KCS and Tex Mex have begun working on an initiative with TFM to create a similar plan for operational efficiency going northbound, to include the possibility of TFM pre-blocking traffic to save handling and transit time on traffic moving from Mexico to the US Markets.

In a final note regarding the NAFTA Railway Alliance meeting, another key topic was that of future projects like the implementation of MCS on KCS this summer and on Tex Mex later this year. The shared computer system will help KCS and Tex Mex to provide more accurate and timely information to customers, and further improve the convenience of doing business on the NAFTA Railway.

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December 17, 2002

State of the Railroad: From the Desk of Michael R. Haverty, Chairman, President and CEO

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As we near the end of 2002, I would like to share with you my thoughts on the state of the railroad, and where I believe we need to be headed next year.

This year is best described as a pivotal turning point. In 2002, we set out to strengthen our balance sheet by increasing revenue, decreasing expenses and paying down debt. A variety of initiatives targeted at meeting these objectives were implemented and significant progress was made. In 2003, we must seize this opportunity to build on our progress, especially taking advantage of the tools now available to us and moving full speed ahead.

In the transportation industry, freight scheduling technology is the greatest opportunity to improve customer service and decrease operating costs. On a technology scale of one to ten, KCS instantaneously went from a one to a ten with the cutover from the Legacy System to the state-of-the-art, operating system, MCS. We are long past the point of implementation. Now, with a comprehensive understanding of our customers' needs, we must utilize the more accurate and timely information provided by MCS to plan and then execute with discipline, in order to meet our customers' requirements. More timely and reliable service gives us the ability to simultaneously grow our revenue and reduce our costs. This spring, MCS will be implemented on Tex-Mex, and on TFM in the fall, further extending the power of information for creating seamless interchange among our family of railroads.

For the customer, MCS offers the greatest benefits to the most service sensitive traffic. The largest growth potential for this type of traffic is over the Meridian to Dallas and Meridian/Jackson to Laredo corridors. In the year ahead, enhancements to the Meridian Speedway, such as added capacity and sidings, will provide a turning point toward improving transit times to better serve existing customers, as well as to support new business, such as the Nissan plant in Canton, Miss. By the second quarter, 12 power-assisted switches will be installed in dark territory on the Vicksburg and Meridian Subdivisions, allowing train crews to control the switches within their authority from the lead locomotive on their train instead of on the ground. New tracks will be added through and to the west end of Jackson's High Oak Yard to facilitate traffic flow between the yard and the transload facility, which will also be expanded. The Jackson transload facility is one of the most significant revenue-generating links in KCS' Transload Center (TLC) network.

KCS continues to reap the benefits of its investment in Mexico, as traffic continues to grow at 15 percent a year. Our working relationship with TFM has become very close in 2002, and we expect to further strengthen and build this relationship in 2003. With the reauthorization of the Transportation Equity Act for the 21st century (TEA-21) legislation and other legislative efforts, KCS could seek public participation in several projects, including Tex-Mex projects that would benefit both the public and KCS.

KCS' alliance with CN remains advantageous for both partners - a relationship that will celebrate its fifth anniversary in early 2003. Our alliance with IC&E has already seen huge gains in grain

traffic, while our alliance with BNSF is just beginning to pick up steam. These strategic alliances continue to strengthen our position as the NAFTA Railway, and when fully realized will promote greater industry cooperation, increase revenue and extend market reach.

In 2003, BELTPACK will be one of the most effective tools for KCS reducing yard incidents and providing productivity gains. We will have 57 jobs in 21 yards operating BELTPACK locomotive remote control systems. KCS must fully utilize BELTPACK to remain competitive.

Everyday, we build for the future, a culture in which safety is a value, not a priority subject to change. In 2002, attentions were diverted and individual safety performance suffered as a result. However, progress is already being made with extensive training in all craft areas and enhancement of the operations testing process. The derailment prevention initiative that began this year demonstrated a 50 percent cost reduction for reportable derailments. Practice of Responsible Care codes is 85 percent in place, and as of November, crossing collisions have decreased year over year by 16 percent. KCS further extends outreach efforts into the community with education, training and local coordination. The combined efforts of all employees will help KCS to achieve our safety vision of becoming the safest railway in North America.

Finally, in the first half of 2003, KCS will implement Enterprise Workforce Management (EWM), a computerized system to increase payroll accuracy and timeliness, and provide daily operations expense reports to improve the management of the railroad. In scope and investment, EWM is second only to MCS. This state-of-the-art system will play a major role in assuring that each paycheck is right and on time.

While these investments provide tremendous opportunities to improve service to customers and increase shareholder value, KCS like the rest of the industry and North America face some daunting challenges. For yet another year, the economy remains uncertain, as does the potential for acts of terrorism. In response, we will continue to tighten our belts and tighten the reins on security. Our industry has been repeatedly complimented for the security measures taken, but we must not let down our guard. The key is cooperation between shippers and carriers to certify a shipment at origin and ensure its security throughout the trip to its ultimate destination.

The steps we must take to succeed in 2003 are clear. Every KCS employee must understand how his/her role affects both revenue and expenses. We must focus on understanding and serving our customers' needs and meeting their requirements consistently. By doing so, we will move in the right direction toward critical measures, such as improving safety performance, decreasing dwell time, completing work orders promptly and improving on-time origins and departures. By working together, communicating and utilizing the technology available to us, we will at the close of 2003, be able to say that we have accomplished much.

On behalf of our board of directors and senior management, I would like to express our heartfelt thanks to KCS' employees and friends who have donated financial resources, as well as to those who have tirelessly volunteered their time to ensuring the success of the 2002 Holiday Express. This project generates tremendous goodwill in many of the communities KCS serves and provides assistance to families in need during the holiday season through contributions to The Salvation Army. Your efforts are important to our Company and to the greater community.

As stated on the back of the 2003 KCS calendar, the men and women of the NAFTA Railway are the heart, soul and backbone of our operation and our most valuable resource. I want to take this opportunity to salute your efforts, thank you for your dedication to our customers and wish you a safe and happy holiday season. Right now is the turning point toward a more successful future for our railroad.

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April 8, 2003

KCS, TFM move toward more seamless operation

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This week marks another important step toward creating a more seamless NAFTA Railway operation. TFM officials, Manuel Zulaica, chief transportation officer, Federico Diaz, director fleet management and transportation support, and Steve Radney, project leader, are at KCS' corporate headquarters in Kansas City, Mo., working with Scott Arvidson, KCS chief information officer, and others to formulate a business case for implementing the Management Control System (MCS) on TFM.

Although MCS is a state-of-the art computer operating system that has been successful on KCS, TFM has different opportunities for cost reduction and improved business value that must be considered in the planning stages. The two companies are establishing templates for various components of the project plan, including system integration, change management and training. For each component, effort, expenses and benefits are analyzed. This meeting is one of many steps toward a projected implementation of MCS on TFM in first quarter of 2004.

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5500 Cenex Drive
Inver Grove Heights, MN 55077

July 22, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am Logistics Manager for Agriliance, LLC. We are involved in regular rail trade of fertilizer products to destinations in Mexico.

Agriliance is the agronomy marketing joint venture owned by Land O'Lakes, Inc., Arden Hills, MN; CHS Cooperatives, Inc., St. Paul, MN; and Farmland Industries, Kansas City, MO. Agriliance markets crop nutrients, crop protection products, seed (through Croplan Genetics) and related agronomy services to farmers and ranchers through local cooperatives and independent dealers in all 50 states, Canada and Mexico.

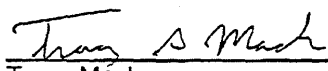
A large percentage of our traffic to Mexico originates on the Union Pacific Railroad.

Agriliance is very much in support of the creation of NAFTA Rail provided the NAFTA Rail carriers agree not to discriminate against traffic originating on the Union Pacific and if TFM continues to support competitive UP-TFM services and rates.

Agriliance is concerned however, that the NAFTA Rail carriers will have opportunities and incentives to undermine competing service on TFM-UP routes. We believe that NAFTA Rail carriers should be willing to back their commitments regarding competitive issues with enforceable conditions or agreements which will insure that the NAFTA Rail carriers will not discriminate against Union Pacific traffic and that TFM will continue to support competitive UP-TFM services and rates.

Provided the board can appropriately secure the competitive structure described,
Agriliance supports of the creation of NAFTA Rail.

I, Tracy Mack, declare under penalty of perjury that
the foregoing is true and correct. Further I certify that I am
qualified and authorized to file this verified statement.
Executed on July 22, 2003



Tracy Mack
Logistics Manager
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AK Steel Corporation
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July 25, 2003

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Finance Docket No. 34342, Kansas City Southern/NAFTA Rail

Dear Secretary Williams:



This letter is being submitted in response to the Board's request for comments relating to the July 31, 2003 public hearing on Kansas City Southern's ("KCS") plans to acquire control of Texas Mexican Railway ("TexMex") and the Transportacion Ferrovaria Mexicana ("TFM"). As explained below, AK Steel does not oppose this transaction, provided that the Board assures that the approval of the transaction will not result in any service or competitive harms to our service.

AK Steel is engaged in the production of flat-rolled carbon, stainless and electrical steels for use in automotive, appliance construction and manufacturing markets. AK Steel employs approximately 11,500 men and women at major steel-working plants and offices in Indiana, Kentucky, Ohio and Pennsylvania. These plants include AK Steel's manufacturing facilities at Rockport, Indiana, Middletown Works and Zanesville, Ohio, and Butler, Pennsylvania. AK Steel relies on railroad transportation to deliver its steel products to end-users located throughout the United States and Mexico. This transportation includes AK Steel shipments of approximately 120,000 tons of rolled steel per year to Mexico.

Currently, AK Steel transports its products to Mexico pursuant to a rail transportation agreement under which CSX Transportation, Inc. ("CSXT") originates steel products from the Middletown Works and Rockport Plants and transports them to Salem, Illinois, where the steel is interchanged to the Union Pacific Railroad Company ("UP"). UP then transports the steel to Laredo, Texas, where it is interchanged with TFM at the International Bridge for final delivery to various manufacturing concerns in Mexico, including General Motors. AK Steel has several alternative routings that are available to move its product to the

The Honorable Vernon A. Williams
July 25, 2003
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Mexican gateway, including routes that involve originations on the Norfolk Southern Railway ("NS"), and/or joint-line movements involving BNSF or KCS.

One of AK Steel's primary concerns in transporting steel products to Mexico is transit time. The transit time of these shipments is affected by a variety of factors, most notably including the amount of time taken to interchange with TFM at the International Bridge at Laredo. AK Steel is concerned that once the formation of the NAFTA Railway is completed, TFM will favor traffic that originates on its affiliated companies, i.e., KCS and TexMex, over interchange traffic received from UP or The Burlington Northern & Santa Fe Railway Company ("BNSF"). If such discriminatory practices occur, there would be a detrimental impact on cycle times, which in turn would greatly impact AK Steel's ability to obtain reliable and efficient transportation service into Mexico.

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

At various times in this proceeding, KCS has represented that it would not "make any changes in the way the Laredo Bridge is dispatched and operated," and that it would "keep the Laredo gateway open on commercially reasonable terms." AK Steel believes that each of these commitments is critical to assuring that the creation of the NAFTA Railway does not harm AK Steel's ability to move its products into Mexico efficiently and at competitively priced transportation rates.

Accordingly, AK Steel hereby requests that the STB condition any approval of the KCS' acquisition of control of TexMex and TFM to protect shippers like AK Steel from potential discriminatory service and pricing practices relating to the Mexican gateway. AK Steel specifically requests that the Board

AK Steel Corporation

The Honorable Vernon A. Williams
July 25, 2003
Page 3

impose conditions that assure that all carriers interchanging traffic at the Laredo bridge be treated fairly by TFM. In addition, AK Steel requests that the Board impose a condition that prevents TFM from exercising bottleneck control. There are currently three carriers that can be used to reach the Mexican gateway at Laredo. Any approval of the acquisition of control sought by KCS must assure that all of these carriers can continue to provide service at commercially reasonable terms.

Thank you for your consideration and attention to this matter.

Sincerely,

A handwritten signature in cursive script that reads "Gary L. Kidwell" followed by a stylized flourish or initials.

Gary L. Kidwell

cc: All Parties of Record

The Honorable Vernon A. Williams
July 25, 2003
Page 4

VERIFICATION

I, GARY L. KIDWELL, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this verified statement. Executed on July 24, 2003.

Gary L. Kidwell 7-24-03



BADGER MINING CORPORATION

409 SOUTH CHURCH ST., P.O. BOX 328, BERLIN, WI 54923
(920) 361-2388 • FAX (920) 361-2826
www.badgerminingcorp.com

July 29, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

My name is Robert Bartol. I am the Manager of Transportation Services for Badger Mining Corporation.

Badger Mining is a privately held international corporation that manufactures industrial silica sand, limestone, zeolite, and other aggregates. Our primary industrial markets include hydraulic fracturing, gravel packing, foundry core and molding applications, industrial and construction fillers, boiler sand, wet grinding media, and fluxing agents. Our products are also used for environmental purposes, such as water filtration, sewage treatment, monitoring wells, remediation wells, and odor control.

Badger Mining ships approximately 40-50 cars per week to Mexico. Our Mexico business consists primarily of silica sand moving to foundries served by TFM in Monterrey and Saltillo. The sand is used in castings to make engine parts for the auto industry. This traffic moves most efficiently from our Fairwater Plant in Wisconsin via the Chicago and Laredo gateways.

We are concerned that the proposed NAFTA Rail transaction might affect the rates and service that UP can offer for our shipments moving over the Laredo Gateway. Our Mexico traffic moves over the Chicago Gateway, so it is susceptible to routings involving KCS. If the NAFTA Rail transaction improves those routings, we would welcome the additional competitive options. However, Mexico is an important growth market for Badger Mining, and we want to ensure that the transaction does not interfere with our ability to use the existing, efficient UP-TFM service.

We understand that KCS has offered several commitments to preserve efficient UP-TFM service over the Laredo Gateway and in Mexico. We appreciate those commitments, but we believe that the Board should make those commitments solid and enforceable. It is our experience in the railroad business that there are many subtle ways to discriminate against competition, so clear,

DC: 915530-2

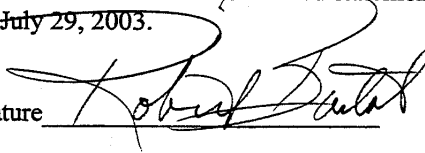
Our mission is to become the quality leader in the industrial minerals industry with a team of people committed to excellence and a passion for satisfying our customers.

enforceable standards are important. KCS and its partners should be required to provide UP with a fair share of the capacity at Laredo Bridge, continue to cooperate with UP with respect to the service that TFM provides in Mexico and not discriminate against UP routings in terms of service, and provide UP with competitive rate factors for UP-TFM routings via the Laredo Gateway. The Board should solidify these requirements by making them enforceable conditions to its approval of the KCS Application.

Thank you for considering our views.

I, Robert Bartol, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this ~~verified~~ statement.
Executed on July 29, 2003.

Signature

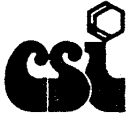


Dynnette K. Wilde

State of Wisconsin

County of Green Lake

7-29-03



Chicago Sweeteners Incorporated

1700 Higgins Road Suite 610 Des Plaines, Illinois 60018
Phone: 847/299-1999 Fax: 847-299-1669 800/367-6975
www.chisweet.com

June 27, 2003

Dear Sir:

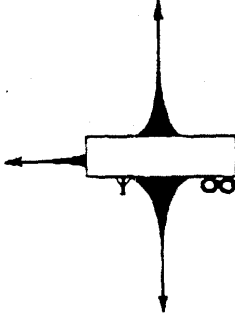
Chicago Sweeteners, Inc is the parent company of Batory De Mexico, which is a manufacturer of food products located in Matamoras MX. We have been a steady shipper of manufactured food products to and from Mexico since 1997. In doing so Batory De Mexico has relied on the Union Pacific and TFM rail systems for an important segment of its logistics network.

Batory De Mexico has learned that the Kansas City Southern Railroad has recently proposed a transaction that would result in its acquisition of Transportacion Ferroviaria Mexicana and the Texas Mexican Railway, and the operation of the three railroads as **NAFTA Rail**. While Batory De Mexico is not opposed to mergers and acquisitions we are opposed strongly to unfair practices in the logistics of border crossings via Union Pacific Railroad. Anything that would discriminate against Union Pacific would be a direct discrimination against all that use its lines to ship to and from Mexico.

Batory De Mexico feels very strongly that any approval of the merger of the KCS, TFM, and the Tex-Mex must be conditioned upon the binding commitment of NAFTA Rail that it will not engage in **unfair practices** to those of us who use Union Pacific to reach Mexican markets or the U.S.. Free trade between our company and companies in Mexico and the U.S. is very important. Unfair practices at the border crossing would greatly impair that business. The service that we have enjoyed over the last 4 years via the existing rail lines has been very efficient. We ask that whatever ventures are allowed in the future that you keep the efficiencies and competitiveness in place for all rail lines.

Sincerely,

Robert V. Tinkham
Executive Vice President



COMPASS CONSOLIDATORS, INC.

47 Stephen Street
Lemont, IL 60439
Phone: (630) 243-0200
Fax: (630) 243-0250

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

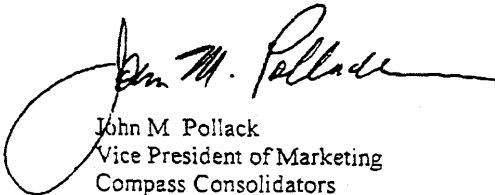
Dear Secretary Williams:

I am John Pollack, Vice President of Marketing at Compass Consolidators, Lemont, IL. Compass Consolidators has been serving the shipping public as an agent specializing in domestic trailerload, boxcar and stack train services since 1976.

Ever since NAFTA was enacted, Compass Consolidators Mexico traffic has been increasing. We look forward to continued Mexico growth as our customers markets expand with business opportunities.

Compass Consolidators does not oppose the merger of the KCS, Tex Mex and TFM railways as long as there is 1. No discrimination against UP traffic at the Laredo Bridge. 2. UP-TFM shipments via the Laredo gateway are not discriminated against and 3. KCS's commitments are concrete and enforceable conditions to STB approval of the transaction.

I, John M. Pollack, declare under penalty of perjury that the foregoing is true and correct. Further I certify that I am qualified and authorized to file this verified statement.
Executed on July 24, 2003.



John M. Pollack
Vice President of Marketing
Compass Consolidators



CONCANNON
lumber company

P.O. BOX 14444
PORTLAND, OREGON 97203

PHONE (503) 231-8881
FAX #(503) 236-5614

July 22, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

My name is Stephen Shaw, and I am the Sales Manager here at Concannon Lumber. We do significant business with Mexico currently and expect that component of our business to do nothing but grow. I expect the proposed NAFTA rail transaction, which will result in KCS acquiring control of Tex Mex and TFM, will affect rail transportation between the United States and Mexico. As a result, we are taking this opportunity to communicate our views to the Surface Transportation Board.

We support all efforts to guarantee that there will be competitive and efficient rail service via the Laredo Gateway. Any restrictions on access to the Gateway will have a negative impact on our business as well as that of our suppliers and receivers. UP today provides U.S.-Mexico service with TFM via Laredo. I understand that KCS has given assurances to the STB that it will work with UP so that UP-TFM service via the Laredo gateway will be handled fairly, efficiently and without discrimination. Therefore, we ask the STB to impose conditions on approval of the transaction. Those conditions will ensure that we continue to receive efficient UP-TFM service offerings. In short, we ask that the STB require the KCS and its partners to commit in concrete and enforceable terms to competitive rail service between the U.S. and Mexico.

We ask that the STB require NAFTA Rail to abide by KCS's promises to provide the following:

- Fair Treatment and Efficient Operations at the Laredo Bridge
- Non-Discrimination for Service in Mexico
- Equitable and Competitive Rate Factors for UP-TFM Routings via the Laredo Gateway

I appreciate the Board's consideration of these views.

Sincerely,

Stephen Shaw, Sales Manager
Concannon Corporation

208538

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Office of Proceedings

JUL 28 2003

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Public Record

Specialists in handling and shipping steel.

July 24, 2003

Honorable Vernon A. Williams
Secretary, Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423



Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am George Drain, General Manager. Our company, CWS, Incorporated, has an established and growing business with Mexico. I expect the proposed NAFTA rail transaction, which will result in KCS acquiring control of Tex Mex and TFM, will affect rail transportation between the United States and Mexico. As a result, we are taking this opportunity to communicate our views to the Surface Transportation Board.

We support all efforts to guarantee that there will be competitive and efficient rail service via the Laredo Gateway. Any restrictions on access to the Gateway will have a negative impact on our business as well as that of our suppliers and receivers. UP today provides U.S.-Mexico service with TFM via Laredo. I understand that KCS has given assurances to the STB that it will work with UP so that UP-TFM service via the Laredo gateway will be handled fairly, efficiently and without discrimination. Therefore, we ask the STB to impose conditions on approval of the transaction. Those conditions will ensure that we continue to receive efficient UP-TFM service offerings. In short, we ask that the STB require the KCS and its partners to commit in concrete and enforceable terms to competitive rail service between the U.S. and Mexico.

We ask that the STB require NAFTA Rail to abide by KCS's promises to provide the following:

- Fair Treatment and Efficient Operations at the Laredo Bridge
- Non-Discrimination for Rates and Service in Mexico
- Equitable and Competitive Rate Factors for UP-TFM Routings via the Laredo Gateway

I appreciate the Board's consideration of these views.

Sincerely,

George Drain, Jr.
General Manager
CWS, Incorporated

C.W.S., Inc. 5137 Indianapolis Blvd.; E. Chicago, IN 46312 FAX: 219-391-0021

Dal-Tile

July 23, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am responsible for the cost of rail shipments of raw materials to our plants in Mexico and the U.S.. Our company, Dal-Tile, has an established and growing business with Mexico. I expect the proposed NAFTA rail transaction, which will result in KCS acquiring control of Tex Mex and TFM, will affect rail transportation between the United States and Mexico. As a result, we are taking this opportunity to communicate our views to the Surface Transportation Board.

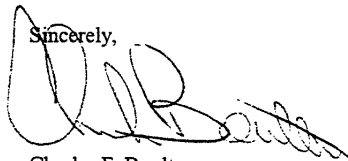
We support all efforts to guarantee that there will be competitive and efficient rail service via the Laredo Gateway. Any restrictions on access to the Gateway will have a negative impact on our business as well as that of our suppliers and receivers. UP today provides U.S.-Mexico service with TFM via Laredo. I understand that KCS has given assurances to the STB that it will work with UP so that UP-TFM service via the Laredo gateway will be handled fairly, efficiently and without discrimination. Therefore, we ask the STB to impose conditions on approval of the transaction. Those conditions will ensure that we continue to receive efficient UP-TFM service offerings. In short, we ask that the STB require the KCS and its partners to commit in concrete and enforceable terms to competitive rail service between the U.S. and Mexico.

We ask that the STB require NAFTA Rail to abide by KCS's promises to provide the following:

- Fair Treatment and Efficient Operations at the Laredo Bridge
- Non-Discrimination for Service in Mexico
- Equitable and Competitive Rate Factors for UP-TFM Routings via the Laredo Gateway

I appreciate the Board's consideration of these views.

Sincerely,



Charles F. Boulter
Manager Industrial Purchasing
Corporate Purchasing

7834 C.F. Hawn Freeway Dallas, TX 75217 Office 214-309-4130
Fax 214-309-4324
Email charles.boulter@daltile.com

FMC Corporation

Alkali Chemicals Division
1735 Market Street
Philadelphia Pennsylvania 19103
215 299 8000



July 17, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Dear Secretary Williams:

This is in reference to Kansas City Southern/NAFTA Rail Finance Docket No. 34342.

My name is John L. Abbott, Distribution Strategy Manager for FMC Corporation, which is located at 1735 Market Street in Philadelphia, PA 19103. FMC is the world's largest producer of natural soda ash (sodium carbonate; STCC 2812322) and is the market leader in North America. We manage one of the industry's largest and private covered hopper car fleets to transport this commodity from our mines in Westvaco, WY to domestic and international markets. FMC is a member of ANSAC (American Natural Soda Ash Corporation), which markets soda ash to worldwide markets. These exports move in trainload quantities from Wyoming to ports located on the west coast and in the Gulf. FMC also moves over 100,000 tons a year via the Laredo, TX interchange to markets located in Mexico.

FMC supports the creation of the NAFTA rail system as long as it does not discriminate nor disadvantage the UP at the International Bridge at Laredo. The Surface Transportation Board needs to ensure shippers such as FMC that the UP-TFM services and rates remain competitive with NAFTA Rail.

I, John L. Abbott, declare under penalty of perjury that the foregoing is true and correct. Further I certify that I am qualified and authorized to file this verified statement executed on July 17, 2003.

A handwritten signature in cursive script that reads "John L. Abbott". The signature is written over a horizontal line.

A handwritten signature in cursive script that reads "Mary Ellen Divito". The signature is written over a horizontal line.

MARY ELLEN DIVITO
COMMONWEALTH OF PENNSYLVANIA
COMMISSIONER OF DEEDS
My Commission Expires April 20, 2004



General Chemical Products, Inc.

90 East Halsey Road
Parsippany, NJ 07054
Tel: 973-515-0000
Fax: 973-515-1070

July 16, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

Re: Kansas City Southern/NAFTA Rail
Finance Docket No. 34342

Dear Secretary Williams:

My name and position title is Karl L. Shetler, General Manager-Transportation for General Chemical Industrial Products, Inc., 90 East Halsey Road, Parsippany, NJ 07054. I have been the General Manager-Transportation for 17 years, responsible for finished product and raw material transportation costs and service.

General Chemical Industrial Products is a leading producer of soda ash and calcium chloride in North America. Soda ash is used in the manufacture of glass, sodium-based chemicals including baking soda, detergents, paper and many familiar consumer products. Calcium chloride is used primarily in highway and road maintenance for dust control and roadbed stabilization during the summer and for de-icing during the winter.

The Company's active soda ash facility is located in Green River, WY. This location is the third largest soda ash facility in North America with an annual production capacity of 2,800,000 NT. Our primary mode of shipment is via rail in private cover hopper cars. In 2002 we shipped in excess of 20,000 railcars from our Green River, WY location which is serviced by the Union Pacific Railroad (UP). The Company is a member of ANSAC, a soda ash export cooperative organized in 1984 under the Webb-Pommerene Act. Through ANSAC a portion of our Wyoming shipments are directed to Mexico via the Laredo, TX rail gateway.

The purpose of this letter is to provide our comments regarding the impact of the Kansas City Southern's (KCS) proposed acquisition of the Transportacion Ferroviaria Mexicana (TFM) and The Texas Mexican Railway (TexMex). Finance Docket No. 34342 considers approval by the Surface Transportation Board of the application by the KCS for this new entity to be called "NAFTA Rail".

The UP currently has coordinated service with the TFM set up via Laredo, TX, including several daily run-through trains with pre-blocking of railcars. The UP has spent significant capital to improve border facilities and to automate customs activities to help the flow of international shipments between the U.S. and Mexico. There is significant automotive, grain and intermodal traffic shipped via the UP-TFM route through Laredo. Our ANSAC shipments to Mexico are routed in this same manner.

Our Company requests that the Surface Transportation Board impose specific conditions on the approval of this application by the KCS to ensure continued competitive and efficient rail service via the Laredo gateway for customers using the current UP-TFM rail routing.

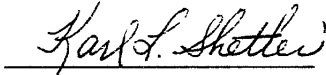
Sincerely yours,

General Chemical Industrial Products, Inc.



Karl L. Shetler
General Manager-Transportation

I, Karl L. Shetler, declare under penalty of perjury that the forgoing is true and correct. Further I certify that I am qualified and authorized to file this verified statement. Executed on July 16, 2003.





Global Motors

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

July 21, 2003

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am Peter Rafael Rodriguez. Our company, Global Motors S.A. de C.V., has an established and growing business with Mexico. I expect the proposed NAFTA rail transaction, which will result in KCS acquiring control of Tex Mex and TFM, will affect rail transportation between the United States and Mexico. As a result, we are taking this opportunity to communicate our views to the Surface Transportation Board.

We support all efforts to guarantee that there will be competitive and efficient rail service via the Laredo Gateway. Any restrictions on access to the Gateway will have a negative impact on our business as well as that of our suppliers and receivers. UP today provides U.S.-Mexico service with TFM via Laredo. I understand that KCS has given assurances to the STB that it will work with UP so that UP-TFM service via the Laredo gateway will be handled fairly, efficiently and without discrimination. Therefore, we ask the STB to impose conditions on approval of the transaction. Those conditions will ensure that we continue to receive efficient UP-TFM service offerings. In short, we ask that the STB require the KCS and its partners to commit in concrete and enforceable terms to competitive rail service between the U.S. and Mexico.

We ask that the STB require NAFTA Rail to abide by KCS's promises to provide the following:

- Fair Treatment and Efficient Operations at the Laredo Bridge
- Non-Discrimination for Rates and Service in Mexico
- Equitable and Competitive Rate Factors for UP-TFM Routings via the Laredo Gateway

I appreciate the Board's consideration of these views.

Sincerely,

Rafael Rodriguez
Director General



Rio Tiber 87 - 401
Col. Cuauhtemoc
Mexico D.F. 06500

Tel. 5533-0417
5533-0416



GRIFFIN INDUSTRIES, INC.

July 14, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N. W.
Washington, D.C. 20423

Re: Kansas City Southern/NAFTA Rail
Finance Docket No. 34342

Dear Secretary Williams,

I am Mike Gilbert and I am Senior Product Manager for Griffin Industries in Cold Spring, KY. My company is manufacturer of animal proteins and fat. We ship approximately three to four hundred railcars per year to Mexico. Most all of this routed over the Union Pacific Railroad.

We have some concern over the proposed NAFTA RAIL. Specifically, we do not want to be put in a situation where rates will increase sharply and make it more difficult to do business. We wish to state our support for conditions that will guarantee continued competitive, efficient UP-TFM rail service via the Laredo gateway and that NAFTA Rail will abide by KCS's promises. If this is done, we are then in support of the proposal.

I, Mike Gilbert, declare under penalty of perjury that the foregoing is true and correct. Further I certify that I am qualified and authorized to file this verified statement.
Executed on July 14, 2003

Mike Gilbert



Ellen C. Goins
ELLEN C. GOINS
Notary Public, State-at-Large, Ky
My Commission Expires December 5, 2005

HUB GROUP, INC.
3050 HIGHLAND PARKWAY, SUITE 100
DOWNERS GROVE, IL 60515

THOMAS L. HARDIN
PRESIDENT AND
CHIEF OPERATING OFFICER

July 17, 2003

Mr. Vernon A. Williams, Secretary
Surface Transportation Board
1925 K Street, NW
Washington, DC 20423-0001

RE: *Kansas City Southern -- Control -- The Kansas City Southern Railway
Company, Gateway Eastern Railway Company, And The Texas Mexican
Railway Company (STB Finance Docket No. 34342)*

Dear Mr. Williams:

This is to further supplement my earlier letter to you dated April 28, 2003 (copy attached) whereby Hub Group has registered its support for the KCS control application.

This is to further clarify our position whereby Hub Group also strongly supports conditions that will guarantee continued competitive and efficient UP/TFM rail service via the Laredo gateway. We believe the UP connection at Laredo must be preserved, as it is vitally important to the continued success of NAFTA.

Please consider our views.



Thomas L. Hardin



Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

IMC Chemicals Inc.
9401 Indian Creek Parkway
Building 40, Suite 1000
Overland Park, Kansas 66210
913.344.9500

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am William J. McGinn, Director of Distribution for IMC Chemicals Inc. IMC Chemicals Inc. operates a chemical manufacturing facility in Trona California and its cooperate office is located in Overland Park Kansas. Our facility in Trona California manufactures approximately 1,700,000 tons of chemicals including sodium carbonate, sodium sulfate and various sodium borates. Our products are shipped through out North America and to 30 countries around the world.

IMC shipments to Mexico of sodium sulfate and sodium borates total approximately 20,000 tons annually. All shipments are made via the Union Pacific Railroad and the Laredo Texas gateway is used exclusively.

While IMC supports the proposed NAFTA rail transaction, IMC is very concerned about the effect of the merger on UP customers using the Laredo Texas gateway. IMC hopes the Surface Transportation Board proposes conditions that ensure that NAFTA Rail lives up to the stated Kansas City Southern Railway Company commitments.

I, William J. McGinn, declare under penalty of perjury that the foregoing is true and correct. Further I certify that I am qualified and authorized to file this verified statement.

Executed on July 23, 2003

William J. McGinn

INCON

Container

USA Ltd.

3125 Fortune Way, Suite 16
Wellington, FL 33414

Tel (561) 791-4544
Fax (561) 791-4550

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

July 25th, 2003.

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am Chet A. Biernat and President. Our company, INCON Container has an established and growing business with Mexico. I expect the proposed NAFTA rail transaction, which will result in KCS acquiring control of Tex Mex and TFM, will affect rail transportation between the United States and Mexico. As a result, we are taking this opportunity to communicate our views to the Surface Transportation Board.

We support all efforts to guarantee that there will be competitive and efficient rail service via the Laredo Gateway. Any restrictions on access to the Gateway will have a negative impact on our business as well as that of our suppliers and receivers. UP today provides U.S.-Mexico service with TFM via Laredo. I understand that KCS has given assurances to the STB that it will work with UP so that UP-TFM service via the Laredo gateway will be handled fairly, efficiently and without discrimination. Therefore, we ask the STB to impose conditions on approval of the transaction. Those conditions will ensure that we continue to receive efficient UP-TFM service offerings. In short, we ask that the STB require the KCS and its partners to commit in concrete and enforceable terms to competitive rail service between the U.S. and Mexico.

We ask that the STB require NAFTA Rail to abide by KCS's promises to provide the following:

- Fair Treatment and Efficient Operations at the Laredo Bridge
- Non-Discrimination for Rates and Service in Mexico
- Equitable and Competitive Rate Factors for UP-TFM Routings via the Laredo Gateway

I appreciate the Board's consideration of these views.

Sincerely,

Chet A. Biernat
Chet A. Biernat,
President.

Knichel Logistics

July 24, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

**Re: Kansas City Southern / NAFTA Rail,
Finance docket No. 34342**

Dear Secretary Williams:

My name is William Knichel, and I am President and CEO of Knichel Logistics, LP, a transportation company based in western Pennsylvania.

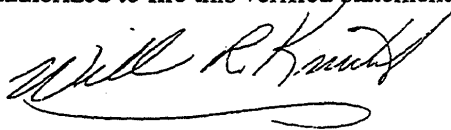
We are active in arranging for the transportation of goods to and from Mexico for a major shipper and manufacturer of power tools via the gateway of Laredo, Texas. Currently we are quoting on potential rail volumes of 20-50 shipments per day. In the past we have moved various other commodities to include furniture, chemicals and other finished goods.

My concern is regarding the recent proposed NAFTA rail transactions that may affect the competitive impacts of rail service via the Laredo gateway. It is of the utmost importance that there be clearly defined controls regulating the fair handling of traffic between the Union Pacific Railroad and the NAFTA Rail. Otherwise our customers will be held captive to a monopoly of rates and services that can undermine the current benefits of utilizing the Laredo gateway.

In order to protect our interest as well as the interests of our manufacturing partners in Mexico, we request that there be enforceable terms established for the fair handling of service between the KCS-TFM option that the NAFTA Rail transaction might bring and the UP TFM for service between Mexico and the U.S. via the Laredo bridge.

I, William Knichel, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this verified statement. Executed on July 24, 2003.

Wrk/



208562

Larson Grain Company

Englevale, ND

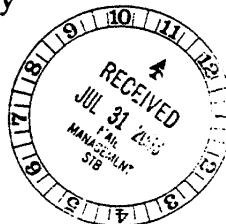
July 22, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

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Office of Proceedings

JUL 31 2003

Part of
Public Record



Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am Tom Gilley, General Manager of Larson Grain Company, Englevale, ND. Our company, Larson Grain Company, has an established and growing business with Mexico. I expect the proposed NAFTA rail transaction, which will result in KCS acquiring control of Tex Mex and TFM, will affect rail transportation between the United States and Mexico. As a result, we are taking this opportunity to communicate our views to the Surface Transportation Board.

We support all efforts to guarantee that there will be competitive and efficient rail service via the Laredo Gateway. Any restrictions on access to the Gateway will have a negative impact on our business as well as that of our suppliers and receivers. UP and BNSF today provides U.S.-Mexico service with TFM via Laredo. I understand that KCS has given assurances to the STB that it will work with UP and BNSF so that service via the Laredo gateway will be handled fairly, efficiently and without discrimination. Therefore, we ask the STB to impose conditions on approval of the transaction. Those conditions will ensure that we continue to receive efficient service offerings. In short, we ask that the STB require the KCS and its partners to commit in concrete and enforceable terms to competitive rail service between the U.S. and Mexico.

We ask that the STB require NAFTA Rail to abide by KCS's promises to provide the following:

- Fair Treatment and Efficient Operations at the Laredo Bridge
- Non-Discrimination for Service in Mexico
- Equitable and Competitive Rate Factors for BNSF and UP Routings via the Laredo Gateway

I appreciate the Board's consideration of these views.

Sincerely,



July 23, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am Robin Farner, Logistics Manager of Pacesetter Steel Service, Inc. Our company has potential growth business with Mexico. I expect the proposed NAFTA rail transaction, which will result in KCS acquiring control of Tex Mex and TFM, will affect rail transportation between the United States and Mexico. As a result, we are taking this opportunity to communicate our views to the Surface Transportation Board.

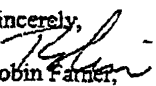
We support all efforts to guarantee that there will be competitive and efficient rail service via the Laredo Gateway. Any restrictions on access to the Gateway will have a negative impact on our business as well as that of our suppliers and receivers. UP today provides U.S.-Mexico service with TFM via Laredo. I understand that KCS has given assurances to the STB that it will work with UP so that UP-TFM service via the Laredo gateway will be handled fairly, efficiently and without discrimination. Therefore, we ask the STB to impose conditions on approval of the transaction. Those conditions will ensure that we continue to receive efficient UP-TFM service offerings. In short, we ask that the STB require the KCS and its partners to commit in concrete and enforceable terms to competitive rail service between the U.S. and Mexico.

We ask that the STB require NAFTA Rail to abide by KCS's promises to provide the following:

- Fair Treatment and Efficient Operations at the Laredo Bridge
- Non-Discrimination for Service in Mexico
- Equitable and Competitive Rate Factors for UP-TFM Routings via the Laredo Gateway

I appreciate the Board's consideration of these views.

Sincerely,


Robin Farner,



Reagent Chemical & Research, Inc.

1300 POST OAK BLVD., SUITE 680, HOUSTON, TX 77056

OFFICE: (713) 628-1843 • FAX: (713) 963-0951

July 10, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423

RE: Kansas City Southern/Nafta Rail
Finance Docket No. 34342

Dear Secretary Williams:

My name is Edwin E. Vigneaux, Traffic Manager for Reagent Chemical & Research, Inc., responsible for rail transportation.

Reagent Chemical is a distributor of Hydrochloric Acid (HCL), doing business in North America. We are currently exporting approximately 5,000 tons of HCL to Mexico and occasionally importing small amounts of HCL from Mexico. The HCL we ship to and from Mexico is routed via UP-TFM or KCS-TFM, via the Laredo gateway.

This letter concerns the announced plans of the Kansas City Southern (KCS) to acquire control of the Transportacion Ferrovaria Mexicana (TFM) and The Texas Mexican Railway (Tex-Mex), thereby operating all three railroads as "NAFTA Rail". Reagent Chemical is not opposed to this acquisition. We believe the joining of these three railroads will offer competitive and safe transportation of our product between the United States and Mexico.

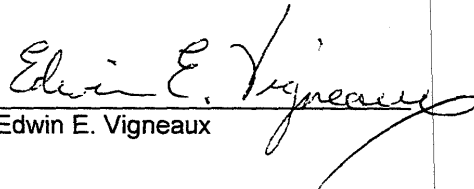
However, we do have concerns that the ownership of the International Bridge at Laredo be under the sole control of the NAFTA Rail carriers, and that those controlling the bridge continue to offer the UP complete and uninhibited access to the bridge crossing. In order for our company to receive the most economical and consistent transportation of our product to Mexico, we must have open competition between the UP and the NAFTA rail carriers. We believe the only way to achieve this is for the NAFTA carriers to keep this gateway open on commercially reasonable terms.



Reagent Chemical & Research, Inc.
Registered to ISO 9002
File # A6831

We understand that the current KCS management has promised the UP neutrality and non-discrimination of current and future traffic flows. We would prefer that the KCS make these promises concrete and enforceable through private agreements or through conditions prescribed by the STB. If the KCS agrees to make these conditions enforceable, then shippers like Reagent would be assured of having the UP-TFM option that is in place today, as well as whatever improved KCS-TFM option the NAFTA rail transaction might bring. We at Reagent Chemical urge the STB to ask the KCS and its partners to commit to concrete and enforceable terms and that current service between the U.S. and Mexico be preserved by preventing discrimination against the UP at the International Bridge in Laredo.

I, Edwin E. Vigneaux, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this verified statement. Executed on July 10, 2003.


Edwin E. Vigneaux



SOLVAY ENGINEERED POLYMERS

100 South Mitchell Road, Mansfield, TX 76063
Telephone: (817) 792-1883
Fax: (817) 792-2856

Honorable Vernon A. Williams
Secretary - Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am John Staben, Jr., Distribution Specialist at Solvay Engineered Polymers. We are a plastics manufacturer.

We ship railcars to Mexico City and Monterrey to support our Automotive customers. Our business consists of plastics to Mexico from the Midwest. Our shipments move via the Laredo gateway into Mexico.

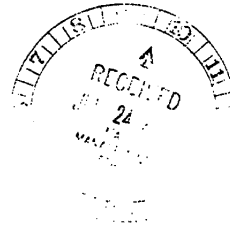
I understand that Kansas City Southern (KCS) is asking for approval to acquire control of the The Texas Mexican Railway (Tex-Mex) as well as the International Bridge at Laredo and the Mexican railroad that also serves the Laredo gateway, the TFM. My company is not opposed to this transaction, if there are firm and enforceable conditions established by the STB which will require KCS to operate the Laredo bridge and the connection with TFM fairly and without discrimination so the current service offered by UP-TFM over this gateway can continue to be offered efficiently and without interference.

The major concern for us is the potential congestion at the border in Laredo, Texas. Our shipments must be delivered in a timely manner so that our customers continue to buy product from us. We rely on efficient transportation over the gateway. We expect KCS to agree to conditions that will preserve and improve the efficient use of the Laredo Bridge.

I, John Staben, Jr., declare under penalty of perjury that the foregoing is true and correct. Further I certify that I am qualified and authorized to file this verified statement. Executed on July 23, 2003.



Unimin Corporation
258 Elm Street, New Canaan, CT 06840
Phone: 203-966-8880 Telex: 99-6355
Fax: 203-966-3453 or 203-972-1870



July 23, 2003

Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

ENTERED
Office of Proceedings
JUL 24 2003
Part of
Public Record

Re: Finance Docket No. 34342

Dear Secretary Williams:

I am Vice President/Distribution of Unimin Corporation. Unimin is one of the nation's largest suppliers of industrial minerals. We mine industrial minerals from over forty locations in the United States. Our products include, among other things, a wide variety of industrial sand, ball clay, feldspar, kaolin, high purity quartz, olivine, bentonite and dolomite. I am writing because we are concerned that Kansas City Southern's (KCS') proposed acquisition of Transportaci3n Ferroviaria Mexicana ("TFM") could raise the cost of shipping industrial minerals to Mexico, which in turn would adversely affect Unimin's business.

Ball Clay

Ball clay is used to make ceramic tile and sanitaryware (toilets, sinks, tubs, etc.). Much of North America's production of ceramic tile and sanitaryware used to be in the Midwestern United States. Over the last 10 years or so, many manufacturers have moved these operations to Mexico, especially the Monterrey area.

Unimin produces ball clay at Gleason, Tennessee, as do three competitors, K-T Clay Corporation, Old Hickory Clay Company, and H.C. Spinks Clay Company. All four Gleason, Tennessee producers are on the CSX line. That line connects to various other carriers, including KCS. In addition, Unimin produces ball clay at Troup, Texas; our plant there is on the Union Pacific ("UP") line.

Our Troup, Texas plant has a transportation advantage over the Tennessee producers for shipments into Mexico by reason of its relative proximity. Accordingly, in 2002, approximately 59 percent of the Troup plant's revenues were from sales to customers in Mexico. About 47 percent of the Troup plant's revenues are from sales to a single customer -

Glass Sands • Frac Sands • Foundry Sands • Foundry Customix • Ground Silica • Feldspar • Nepheline Syenite
High Purity Quartz • Microcrystalline Silica • Dolomite • Olivine • Southern Bentonite • Specialty Sands

Vernon A. Williams
July 23, 2003
Page Two

Dal-Tile in Monterrey. Our customers in Mexico purchase f.o.b. our plant and arrange their own freight. Freight costs for customers in the Monterrey area are almost as much as the cost of the ball clay itself. Truck transportation is not a viable option for these customers, because it is approximately twice as expensive as rail.

Ball clay from the Gleason, Tennessee area is still an excellent substitute for ball clay from our Troup, Texas plant, however. The Tennessee deposits are of a higher quality, and the Tennessee producers enjoy certain efficiencies that allow them to sell at a lower price. Accordingly, a very small change in delivered prices (about half of which are freight) would induce Dal-Tile and other Mexican customers to switch their purchases from our Troup plant to one of the Tennessee plants.

Shipments from our Troup plant to the Monterrey area travel on the UP to Laredo, Texas, and then to Monterrey on the TFM. This is a well-traveled route with consistent service, particularly because UP has invested heavily in the infrastructure at Laredo.

Until now, TFM has had no reason to favor ball clay shipments that originate in Tennessee over shipments that originate in Texas, or vice versa. Following the proposed transaction, TFM will have reason to favor KCS, because they will be under common ownership. If the combined entity raises the price of transporting Unimin's Troup, Texas ball clay from Laredo to Monterrey or uses its control over the Laredo Bridge to make UP's service slower or less predictable, Mexican tile and sanitaryware producers may shift to the Tennessee producers. This will benefit KCS because KCS can carry Gleason, Tennessee ball clay from New Orleans, Louisiana (where CSX connects to KCS) to Laredo. Similarly, TFM and KCS could offer preferential traffic packages to Tennessee customers to enable KCS to carry Gleason, Tennessee ball clay from New Orleans to Laredo.

If Dal-Tile, which is by far the Troup plant's largest customer, were to shift to another supplier, the Troup plant likely would not be viable, and twenty-six Unimin jobs in Troup, Texas would be lost. If this were to happen, TFM would still be shipping the same volume of ball clay into Mexico, but KCS would be shipping more than it currently ships.

We note that UP could carry ball clay from Troup to Eagle Pass, and connect to Ferrocarril Mexicano ("FXE"), which could then haul it to the Monterrey area. However, this FXE routing has several significant disadvantages. First, it is more circuitous, which means that shipments will take longer and cost more. Second, shipments from the United States move much more quickly through Laredo than through Eagle Pass (or Brownsville, for that matter) because there has been much more investment at Laredo. In this business, time is money, and slower service is a significant disadvantage. Similarly, because ball clay moves in carloads instead of unit trains, the less frequent service on the Eagle Pass-FXE route is also a disadvantage. Since the Eagle Pass-FXE route is used much less intensively than the

Vernon A. Williams
July 23, 2003
Page Three

Laredo Bridge, it takes longer on the FXE routing to assemble a trainload of empty cars to return from Mexico to the United States, thus further slowing the cycle time and increasing costs.

Fracturing Sand

Fracturing sand, sometimes known as frac sand, is a type of industrial sand. Fracturing sand is used in secondary recovery for oil and gas wells. Unimin is the largest supplier of fracturing sand in the United States. About 10 percent of the fracturing sand revenues at Unimin's principal fracturing sand plants, located in Kasota and Ottawa, Minnesota, is for shipments to Mexico. Those plants are on the UP. Unimin's main competitor in this area, Badger Mining Corporation in Taylor, Wisconsin, is served by the Canadian National ("CN"), which now owns the former Illinois Central, from which it connects to KCS. The CN and KCS are parties to a marketing agreement.

Again, the entity created by the proposed transaction could discriminate against shipments of Unimin products on the UP, which could shift purchases to Unimin's major competitor that utilizes KCS.

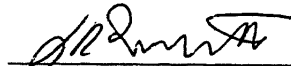
Protecting Competition

We respectfully request that the Board impose detailed conditions of neutrality and non-discrimination in order to preserve competition among rail carriers and to enable Unimin to compete fairly for sales to Mexican customers. The Laredo Bridge cannot be duplicated by competitors, and the other rail crossings from Texas into Mexico are far inferior to it. This Board should not allow control of the Laredo Bridge to confer a competitive advantage on the combined KCS-TFM.

Unimin does not oppose the proposed transaction as long as the Board imposes conditions that will protect competition among KCS, UP, and other carriers. Specifically, the Board should insure that (i) the Laredo Bridge will not be used to discriminate against UP traffic, and (ii) TFM will not discriminate against connecting traffic from carriers other than KCS. This non-discrimination obligation must apply to both price and service to be effective. Indeed, unless the Board makes sure that all aspects of service are covered – including transit times, switching service, and car supply – its remedy will be ineffective.

I, Louis R. Mastandrea, declare under penalty of perjury that the foregoing is true and correct. I further certify that I am qualified and authorized to file this verified statement.

Executed on July 23rd, 2003.



Louis R. Mastandrea
Vice President/Distribution



P.O. BOX 67
GEORGE, IOWA 51237

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street N.W.
Washington, D.C. 20423

RE: Kansas City Southern/NAFTA Rail.
Finance Docket No. 34342

Dear Secretary Williams:

I am Dave Reinders, General Manager at United Farmers Cooperative, George, Iowa.

Our Cooperative is a 100 car-rail shuttle grain shipper. We export via rail approximately 16 million bushels of corn and 4 million bushels of soybeans annually. Many of these trains especially the soybean are shipped to the Mexico market.

I am very concerned about the NAFTA Rail, however it is going to be of the utmost importance that NAFTA Rail lives up to KCS's commitments. I am also concerned about the effect of the proposed transaction on U.P. - TFM service and the treatment of the Union Pacific customer at the Laredo bridge.

Please give these matters your thoughtful consideration

Thank You & Sincerely,
Dave Reinders
General Manager
United Farmers Cooperative
George, Iowa
51237

I Dave Reinders, declare under penalty of perjury, that the foregoing is true and correct. Further I certify that I am qualified and authorized to file this verified statement.

Executed on July 17, 2003.

A handwritten signature in cursive script that reads "Dave Reinders". The signature is written in dark ink and is positioned below the text "Executed on July 17, 2003.".

GEORGE • ASHTON • ALLENDORF • BIGELOW • RUSHMORE

Westwood Forest Products Inc.

2707 Colby Avenue, suite 701, Everett, WA 98201

Phone: 425-259-3836 Fax: 425-339-5554

1-800-359-2238

July 25, 2003

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Kansas City Southern/NAFTA Rail,
Finance Docket No. 34342

Dear Secretary Williams:

I am Steve Fitzgerald, Mexico & US Pulp Fiber Logistics Manager. Our company, Westwood Forest Products, Inc., has an established and growing business with Mexico. I expect the proposed NAFTA rail transaction, which will result in KCS acquiring control of Tex Mex and TFM, will affect rail transportation between the United States and Mexico. As a result, we are taking this opportunity to communicate our views to the Surface Transportation Board.

We support all efforts to guarantee that there will be competitive and efficient rail service via the Laredo Gateway. Any restrictions on access to the Gateway will have a negative impact on our business as well as that of our suppliers and receivers. UP today provides U.S.-Mexico service with TFM via Laredo. I understand that KCS has given assurances to the STB that it will work with UP so that UP-TFM service via the Laredo gateway will be handled fairly, efficiently and without discrimination. Therefore, we ask the STB to impose conditions on approval of the transaction. Those conditions will ensure that we continue to receive efficient UP-TFM service offerings. In short, we ask that the STB require the KCS and its partners to commit in concrete and enforceable terms to competitive rail service between the U.S. and Mexico.

We ask that the STB require NAFTA Rail to abide by KCS's promises to provide the following:

- Fair Treatment and Efficient Operations at the Laredo Bridge
- Non-Discrimination for Service in Mexico
- Equitable and Competitive Rate Factors for UP-TFM Routings via the Laredo Gateway

I appreciate the Board's consideration of these views.

Sincerely,
Steve Fitzgerald



Pulp Fiber Logistics Manager

BEFORE THE
SURFACE TRANSPORTATION BOARD
UNITED STATES DEPARTMENT OF TRANSPORTATION

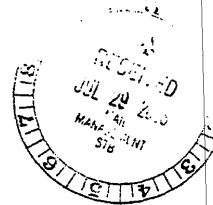
Finance Docket No. 34342

KANSAS CITY SOUTHERN

-- CONTROL --

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

SUBMISSION OF
WEYERHAEUSER COMPANY



Introduction:

My name is John B. Ficker. I am employed by Weyerhaeuser Company as its Logistics Development Manager. My business address is: Weyerhaeuser Company, PO Box 9777 Federal Way, WA 98063-9777. I am familiar with all of Weyerhaeuser's facilities and its transportation requirements. I have worked in the transportation industry for thirty years. I have worked for Weyerhaeuser since 1986. For the first four years of my employment, I was Southern Transportation Manager. In that position, I was responsible for transportation from and to eleven (11) Weyerhaeuser manufacturing facilities and forty (40) distribution centers east of the Rocky Mountains. In 1990, I assumed my current responsibilities, which include reviewing Weyerhaeuser's transportation agreements, determining whether they comply with applicable regulations and statutes, and representing Weyerhaeuser before regulatory agencies. I am a registered practitioner before the Surface Transportation Board and am authorized to represent Weyerhaeuser before federal and state regulatory bodies and present this statement on behalf of Weyerhaeuser.

Background -- Weyerhaeuser is a large user of rail:

Weyerhaeuser is a multi-plant forest products company with facilities across North America. Our 2002 annual sales were over \$18 billion. We manufacture, distribute, and sell logs, woodchips, lumber, plywood, particleboard, hardboard, oriented strandboard, woodpulp, paper, pulpboard, shipping containers, chemicals, and related products. We own and operate large mill complexes in Alabama, Georgia, Mississippi, Kentucky, West Virginia, North & South Carolina, Oklahoma, Oregon, Washington, Louisiana, Tennessee, Pennsylvania, and Wisconsin, and the Canadian provinces of British Columbia, Alberta, Saskatchewan, Ontario, and New Brunswick. We have numerous packaging plants and distribution facilities across the United States, Mexico, and Canada. We also own and operate five Class III shortline common carrier railroads. Weyerhaeuser is a significant user of rail transportation services in both the United States, Canada and Mexico.

Comments on the Proposed Transaction:

Weyerhaeuser believes that the proposed transaction will have a positive impact on the rail environment in both the United States and Mexico, and as such we support the transaction. Weyerhaeuser has some concerns, which we believe the Board should address in this case. The commonly controlled railroad must insure that all existing gateways will remain open and it will not provide undue preference to any gateway. The commonly controlled railroad must continue to offer competitive rates to and from other connecting railroads.

Weyerhaeuser's major concern is the need for the commonly controlled railroad to provide a 'firewall' between its marketing effort and that of the Mexican carrier TFM who will become a partner in the new NAFTA railway. Without such protection, the KCS/TM will have an unfair advantage over the other connecting railroads. The commonly controlled carrier must provide the Board with assurances and process, which can be monitored to insure the impartiality of its Mexican partner in its dealings with other railroads.

Summary:

Weyerhaeuser supports the proposed transaction with the provision that a verifiable 'firewall' can be developed between the Mexican partner and its US partners.

1992 HORIZONTAL MERGER GUIDELINES
[WITH APRIL 8, 1997, REVISIONS TO SECTION 4 ON EFFICIENCIES]

The U.S. Department of Justice ("Department") and Federal Trade Commission ("Commission") today jointly issued Horizontal Merger Guidelines revising the Department's 1984 Merger Guidelines and the Commission's 1982 Statement Concerning Horizontal Merger Guidelines. The release marks the first time that the two federal agencies that share antitrust enforcement jurisdiction have issued joint guidelines.

Central to the 1992 Department of Justice and Federal Trade Commission Horizontal Merger Guidelines is a recognition that sound merger enforcement is an essential component of our free enterprise system benefitting the competitiveness of American firms and the welfare of American consumers. Sound merger enforcement must prevent anticompetitive mergers yet avoid deterring the larger universe of procompetitive or competitively neutral mergers. The 1992 Horizontal Merger Guidelines implement this objective by describing the analytical foundations of merger enforcement and providing guidance enabling the business community to avoid antitrust problems when planning mergers. The Department first released Merger Guidelines in 1968 in order to inform the business community of the analysis applied by the Department to mergers under the federal antitrust laws. The 1968 Merger Guidelines eventually fell into disuse, both internally and externally, as they were eclipsed by developments in legal and economic thinking about mergers.

In 1982, the Department released revised Merger Guidelines which, reflecting those developments, departed dramatically from the 1968 version. Relative to the Department's actual practice, however, the 1982 Merger Guidelines represented an evolutionary not revolutionary change. On the same date, the Commission released its Statement Concerning Horizontal Mergers highlighting the principal considerations guiding the Commission's horizontal merger enforcement and noting the "considerable weight" given by the Commission to the Department's 1982 Merger Guidelines.

The Department's current Merger Guidelines, released in 1984, refined and clarified the analytical framework of the 1982 Merger Guidelines. Although the agencies' experience with the 1982 Merger Guidelines reaffirmed the soundness of its underlying principles, the Department concluded that there remained room for improvement.

The revisions embodied in the 1992 Horizontal Merger Guidelines reflect the next logical step in the development of the agencies' analysis of mergers. They reflect the Department's experience in applying the 1982 and 1984 Merger Guidelines as well as the Commission's experience in applying those guidelines and the Commission's 1982 Statement. Both the Department and the Commission believed that their respective Guidelines and Statement presented sound frameworks for antitrust analysis of mergers, but that improvements could be made to reflect advances in legal and economic thinking. The 1992 Horizontal Merger Guidelines accomplish this objective and also clarify certain aspects of the Merger Guidelines that proved to be ambiguous or were interpreted by observers in ways that were inconsistent with the actual policy of the agencies.

The 1992 Horizontal Merger Guidelines do not include a discussion of horizontal effects

from non-horizontal mergers (e.g., elimination of specific potential entrants and competitive problems from vertical mergers). Neither agency has changed its policy with respect to non-horizontal mergers. Specific guidance on non-horizontal mergers is provided in Section 4 of the Department's 1984 Merger Guidelines, read in the context of today's revisions to the treatment of horizontal mergers.

A number of today's revisions are largely technical or stylistic. One major objective of the revisions is to strengthen the document as an analytical road map for the evaluation of mergers. The language, therefore, is intended to be burden-neutral, without altering the burdens of proof or burdens of coming forward as those standards have been established by the courts. In addition, the revisions principally address two areas.

The most significant revision to the Merger Guidelines is to explain more clearly how mergers may lead to adverse competitive effects and how particular market factors relate to the analysis of those effects. These revisions are found in Section 2 of the Horizontal Merger Guidelines. The second principal revision is to sharpen the distinction between the treatment of various types of supply responses and to articulate the framework for analyzing the timeliness, likelihood and sufficiency of entry. These revisions are found in Sections 1.3 and 3.

The new Horizontal Merger Guidelines observe, as did the 1984 Guidelines, that because the specific standards they set out must be applied in widely varied factual circumstances, mechanical application of those standards could produce misleading results. Thus, the Guidelines state that the agencies will apply those standards reasonably and flexibly to the particular facts and circumstances of each proposed merger.

0. PURPOSE, UNDERLYING POLICY ASSUMPTIONS AND OVERVIEW

These Guidelines outline the present enforcement policy of the Department of Justice and the Federal Trade Commission (the "Agency") concerning horizontal acquisitions and mergers ("mergers") subject to section 7 of the Clayton Act,⁽¹⁾

to section 1 of the Sherman Act,⁽²⁾

or to section 5 of the FTC Act.⁽³⁾ They describe the analytical framework and specific standards normally used by the Agency in analyzing mergers.⁽⁴⁾ By stating its policy as simply and clearly as possible, the Agency hopes to reduce the uncertainty associated with enforcement of the antitrust laws in this area.

Although the Guidelines should improve the predictability of the Agency's merger enforcement policy, it is not possible to remove the exercise of judgment from the evaluation of mergers under the antitrust laws. Because the specific standards set forth in the Guidelines must be applied to a broad range of possible factual circumstances, mechanical application of those standards may provide misleading answers to the economic questions raised under the antitrust laws. Moreover, information is often incomplete and the picture of competitive conditions that develops from historical evidence may provide an incomplete answer to the forward-looking inquiry of the Guidelines. Therefore, the Agency will apply the standards of the Guidelines reasonably and flexibly to the particular facts and circumstances of each proposed merger.

0.1 Purpose and Underlying Policy Assumptions of the Guidelines

The Guidelines are designed primarily to articulate the analytical framework the Agency applies in determining whether a merger is likely substantially to lessen competition, not to describe how the Agency will conduct the litigation of cases that it decides to bring. Although relevant in the latter context, the factors contemplated in the Guidelines neither dictate nor exhaust the range of evidence that the Agency must or may introduce in litigation. Consistent with their objective, the Guidelines do not attempt to assign the burden of proof, or the burden of coming forward with evidence, on any particular issue. Nor do the Guidelines attempt to adjust or reapportion burdens of proof or burdens of coming forward as those standards have been established by the courts.⁽⁵⁾ Instead, the Guidelines set forth a methodology for analyzing issues once the necessary facts are available. The necessary facts may be derived from the documents and statements of both the merging firms and other sources.

Throughout the Guidelines, the analysis is focused on whether consumers or producers "likely would" take certain actions, that is, whether the action is in the actor's economic interest. References to the profitability of certain actions focus on economic profits rather than accounting profits. Economic profits may be defined as the excess of revenues over costs where costs include the opportunity cost of invested capital.

Mergers are motivated by the prospect of financial gains. The possible sources of the financial gains from mergers are many, and the Guidelines do not attempt to identify all possible sources of gain in every merger. Instead, the Guidelines focus on the one potential source of gain that is of concern under the antitrust laws: market power.

The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.⁽⁶⁾ In some circumstances, a sole seller (a "monopolist") of a product with no good substitutes can maintain a selling price that is above the level that would prevail if the market were competitive. Similarly, in some circumstances, where only a few firms account for most of the sales of a product, those firms can exercise market power, perhaps even approximating the performance of a monopolist, by either explicitly or implicitly coordinating their actions. Circumstances also may permit a single firm, not a monopolist, to exercise market power through unilateral or non-coordinated conduct--conduct the success of which does not rely on the concurrence of other firms in the market or on coordinated responses by those firms. In any case, the result of the exercise of market power is a transfer of wealth from buyers to sellers or a misallocation of resources.

Market power also encompasses the ability of a single buyer (a "monopsonist"), a coordinating group of buyers, or a single buyer, not a monopsonist, to depress the price paid for a product to a level that is below the competitive price and thereby depress output. The exercise of market power by buyers ("monopsony power") has adverse effects comparable to those associated with the exercise of market power by sellers. In order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines.

While challenging competitively harmful mergers, the Agency seeks to avoid

unnecessary interference with the larger universe of mergers that are either competitively beneficial or neutral. In implementing this objective, however, the Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipency.

0.2 Overview

The Guidelines describe the analytical process that the Agency will employ in determining whether to challenge a horizontal merger. First, the Agency assesses whether the merger would significantly increase concentration and result in a concentrated market, properly defined and measured. Second, the Agency assesses whether the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects. Third, the Agency assesses whether entry would be timely, likely and sufficient either to deter or to counteract the competitive effects of concern. Fourth, the Agency assesses any efficiency gains that reasonably cannot be achieved by the parties through other means. Finally the Agency assesses whether, but for the merger, either party to the transaction would be likely to fail, causing its assets to exit the market. The process of assessing market concentration, potential adverse competitive effects, entry, efficiency and failure is a tool that allows the Agency to answer the ultimate inquiry in merger analysis: whether the merger is likely to create or enhance market power or to facilitate its exercise.

1. MARKET DEFINITION, MEASUREMENT AND CONCENTRATION

1.0 Overview

A merger is unlikely to create or enhance market power or to facilitate its exercise unless it significantly increases concentration and results in a concentrated market, properly defined and measured. Mergers that either do not significantly increase concentration or do not result in a concentrated market ordinarily require no further analysis.

The analytic process described in this section ensures that the Agency evaluates the likely competitive impact of a merger within the context of economically meaningful markets--i.e., markets that could be subject to the exercise of market power. Accordingly, for each product or service (hereafter "product") of each merging firm, the Agency seeks to define a market in which firms could effectively exercise market power if they were able to coordinate their actions.

Market definition focuses solely on demand substitution factors--i.e., possible consumer responses. Supply substitution factors--i.e., possible production responses--are considered elsewhere in the Guidelines in the identification of firms that participate in the relevant market and the analysis of entry. See Sections 1.3 and 3. A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a "small but significant and nontransitory" increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test. The "small but significant and non-transitory" increase in price is employed solely as a methodological tool for the analysis of mergers: it is not a tolerance level for price

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 34342

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

THE KANSAS CITY SOUTHERN RAILWAY COMPANY'S
AND THE TEXAS MEXICAN RAILWAY COMPANY'S
RESPONSES AND OBJECTIONS TO
CANADIAN NATIONAL RAILWAY COMPANY'S
FIRST SET OF DOCUMENT PRODUCTION REQUESTS
AND INTERROGATORIES TO APPLICANTS

Pursuant to 49 C.F.R. §§ 1114.21-.31, Kansas City Southern, The Kansas City Southern Railway Company, Gateway Eastern Railway Company, The Texas Mexican Railway Company, and Mexrail, Inc. (collectively "Respondents") respond to the discovery requests served by Canadian National Railway Company ("CN") on June 17, 2003 (the "Requests") as follows:

GENERAL RESPONSES

Respondents hereby provide the following general objections to the June 17, 2003 discovery requests served by CN:

1. The use of "KCS" in these responses shall include Kansas City Southern, The Kansas City Southern Railway Company and Gateway Eastern Railway Company.
2. The use of "Tex Mex" in these response shall mean The Texas Mexican Railway Company and Mexrail, Inc.

reduction of source competition.” Produce all documents considered by Mr. Grimm in connection with this presumption.

RESPONSE: The “strong presumption” referenced by Dr. Grimm arises from a review of the systems referred to in his statement. The fact that the Mexican and U.S. systems connect at the Laredo Bridge (and KCS and Tex Mex connect at Beaumont) with no overlapping routes serves as the bases for the presumption.

2. State whether Curtis Grimm considers source competition to be a form of horizontal competition or some other type of competition, and, if some other type of competition, identify the type and explain why it is not a form of horizontal competition.

RESPONSE: Source competition, as Dr. Grimm defines it in his two verified statements, involves a reduction in independent railroad routings and could be considered a form of horizontal competition.

3. State whether Curtis Grimm examined the possibility and extent of competition between (a) movements of a commodity originating in Mexico, moving over TFM, and terminating at U.S. destinations, on the one hand, and, on the other, (b) movements of the same or a substitutable commodity originating on or otherwise moving over KCS or Tex Mex and terminating at the same U.S. destinations. If the answer is affirmative, describe the results of the examination and produce all documents considered in connection with the examination. If the answer is negative, explain why Mr. Grimm did not examine the possibility and produce all documents considered by Mr. Grimm in connection with the answer.

RESPONSE: Dr. Grimm did not consider the possibility referenced in Interrogatory No. 3 because it would not result in a reduction of independent railroad routings.

4. Does Curtis Grimm contend that there are no imports to the U.S. from Mexico that move by rail over TFM and compete with U.S.-originated products that move by rail over KCS or Tex Mex and terminate at the same U.S. destinations as the imports from Mexico? Please explain the answer and produce all documents considered by Mr. Grimm in connection with the answer.

RESPONSE: Dr. Grimm makes no such contention.

5. State whether Curtis Grimm examined the possibility and extent of competition between (a) movements of a commodity originating in Mexico and terminating on TFM, on the one hand, and, on the other, (b) movements of the same or a substitutable commodity originating on or otherwise moving over KCS or Tex Mex and terminating at the same TFM destinations. If

the answer is affirmative, describe the results of the examination and produce all documents considered in connection with that examination. If the answer is negative, explain why Mr. Grimm did not examine the possibility and produce all documents considered by Mr. Grimm in connection with the answer.

RESPONSE: Dr. Grimm did not consider the possibility referenced in Interrogatory No. 5 because it would not result in a reduction of independent railroad routings.

6. Does Curtis Grimm contend that there are no exports from the U.S. to Mexico that move by rail over KCS or Tex Mex and compete with Mexican-originated products that terminate at the same Mexican destinations and that move by rail over TFM? Please explain the answer and produce all documents considered in connection with the answer.

RESPONSE: Dr. Grimm makes no such contention.

7. State TFM's stated reasons for desiring, and KCS's reasons for agreeing to, Article VII of the Stock Purchase Agreement.

RESPONSE: Respondents object to Interrogatory No. 7 on the grounds that it seeks information that is neither relevant nor reasonably calculated to lead to the discovery of admissible evidence. Without waiver of these objections, to the best of Respondents' recollection, TFM did not state any reason for desiring Article VII of the Stock Purchase Agreement. KCS proposed the call right by TFM so that if the Tex Mex transaction were rejected by regulators, TFM could regain possession of Tex Mex (or at least control its disposition). In addition, if the conditions placed on KCS's control of Tex Mex are too onerous that it damages TFM's access to improved competitiveness, the call right allows TFM to repurchase Tex Mex, returning the situation to the status quo.

8. Explain whether and how Article VII of the Stock Purchase Agreement will, during the period prior to termination of the repurchase right, affect KCS's incentives to maintain and invest in Tex Mex, or enhance Tex Mex service, and why Article VII is consistent with the public interest.

Respectfully submitted,



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July 2, 2003

REDACTED - To be filed on the public record

TM-44

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Finance Docket No. 32760

**UNION PACIFIC CORP., UNION PACIFIC RR. CO. AND
MISSOURI PACIFIC RR CO.
- CONTROL AND MERGER -
SOUTHERN PACIFIC RAIL CORP., SOUTHERN PACIFIC
TRANS. CO., ST. LOUIS SOUTHWESTERN RW. CO.,
SPCSL CORP. AND THE DENVER AND RIO GRANDE WESTERN CORP.**

**THE TEXAS MEXICAN RAILWAY COMPANY'S
PETITION TO REOPEN DECISION NO. 44**

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Attorneys for The Texas
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September 3, 1996

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

**Union Pacific Corp., Union Pacific
RR. Co. and Missouri Pacific RR Co.
— Control and Merger — Southern
Pacific Rail Corp., Southern
Pacific Trans. Co., St. Louis
Southwestern Rw. Co., SPCSL Corp.
and The Denver and Rio Grande
Western Corp.**

Finance Docket No. 32760

**THE TEXAS MEXICAN RAILWAY COMPANY'S
PETITION TO REOPEN DECISION NO. 44**

Pursuant to 49 C.F.R. § 1115.3, the Texas Mexican Railway Company ("Tex Mex") files this petition to reopen the Board's Decision No. 44 in this proceeding.

Introduction and Summary

By this petition, Tex Mex requests the Board to remove the limitation imposed in that decision on the trackage rights granted to Tex Mex in Sub-Nos. 13 and 14 restricting Tex Mex's use of such rights to "the transportation of freight having a prior or subsequent movement on [Tex Mex's] Laredo-Robstown-Corpus Christi line." That limitation will have a relatively minor effect on Applicants' traffic but will have a major adverse effect on Tex

as a viable competitor to a merged UPSP. The evidence of Tex Mex's witnesses showed that granting unrestricted rights will produce \$822,000 more in revenues and \$250,000 more in net income to Tex Mex in the first year of operation than granting rights limited to traffic having a prior or subsequent movement on Tex Mex's line. In fact, the evidence showed that granting limited rights would leave Tex Mex with only \$19,000 in net income in the first year of operation (instead of \$269,000 with unrestricted rights). That income, though not negative, provides Tex Mex with little margin for weathering business cycles and, more importantly, competing aggressively for traffic.

These errors in the Board's decision are discussed more fully below and in the attached verified statements of Tex Mex's economic witnesses, Dr. Curtis Grimm and Joseph Ellebracht.^{2/}

STATEMENT OF FACTS

On March 29, 1996, Tex Mex filed a responsive application seeking trackage rights over SP and UP lines from Robstown and Corpus Christi, Texas through Houston to a connection with KCS at Beaumont, Texas (Finance Docket No. 32760, Sub-No. 13) together with an application for terminal trackage rights over lines of the HB&T in Houston (Finance Docket No. 32760, Sub-No. 14). In those applications (contained in TM-23), Tex Mex stated:

^{2/} This petition for reopening is based on material error and, to the extent the attached verified statements present new evidence, on new evidence. 49 C.F.R. § 1115.3(b). These statements appear as Appendices A and B hereto.

Tex Mex seeks rights over those lines to permit it to carry overhead traffic and to serve all local shippers currently capable of receiving service from both the Union Pacific Railroad ("UP") and the Southern Pacific Transportation Company ("SP"), directly or through reciprocal switching, with full rights to interchange traffic with UP, SP and any other railroad at any interchange point on such lines.

TM-23 at 3. See also TM-23 at 158-174 (Operating Plan).

Tex Mex contended that the foregoing trackage rights were needed to preserve competition that would otherwise be lost as a result of the merger. Tex Mex also contended that they were needed to keep Tex Mex viable and thereby preserve essential rail services provided by Tex Mex for which there are no other transportation alternatives. Tex Mex's arguments and evidence concerning competition focused primarily on the importance of preserving competition in the market for rail services between the United States and Mexico, because that is a market in which Tex Mex is currently an important participant and because preserving competition in that market is vital to the policies of both countries as reflected in the North American Free Trade Agreement.

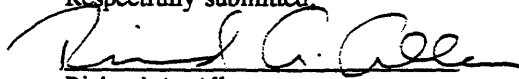
Tex Mex's arguments and evidence, however, were not limited to just that market. By seeking the right to use the trackage rights to serve all shippers currently capable of receiving service from both UP and SP and by seeking full interchange rights with all other railroads at any point on the lines, such as HB&T and the Port Terminal Railway Association ("PTRA") in Houston, Tex Mex's applications served to preserve the existing level of competition for all shippers on the lines in question with respect to all their traffic, not just that moving to and from Mexico or to and from points on Tex Mex's current line. Thus, the traffic and revenue projections in Tex Mex's traffic study, performed by Joseph Ellebracht,

Although Tex Mex correctly stated in its rebuttal statement that it could survive without this traffic, it should be apparent that its survival will be extremely tenuous under the limitation imposed by the Board.²⁷ Its marginal income will hardly be sufficient to permit it to weather adverse business cycles of any substantial duration, and will make it very difficult to compete aggressively against UPSP and BNSF with its trackage rights.

CONCLUSION

The Board should reopen Decision No. 44 in this proceeding and remove the routing restriction on the trackage rights granted to Tex Mex in Sub-No. 13 and Sub-No. 14.

Respectfully submitted,



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Dated: September 3, 1996

²⁷ As noted earlier, Tex Mex's submission of evidence showing that it could survive without this traffic was not to suggest that the traffic was unimportant but was for the purpose of ensuring that the Board would not reject its applications in their entirety if it concluded, contrary to Tex Mex's contention, that the right to carry it had not been justified.

REDACTED - To be filed on the public record

TM-34

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

Comments Exhibit 17
Public

Finance Docket No. 32760

**UNION PACIFIC CORP., UNION PACIFIC RR. CO. AND
MISSOURI PACIFIC RR CO.
- CONTROL AND MERGER -
SOUTHERN PACIFIC RAIL CORP., SOUTHERN PACIFIC
TRANS. CO., ST. LOUIS SOUTHWESTERN RW. CO.,
SPCSL CORP. AND THE DENVER AND RIO GRANDE WESTERN CORP.**

Finance Docket No. 32760, Sub No. 13

**THE TEXAS MEXICAN RAILWAY CO.
- TRACKAGE RIGHTS OVER LINES OF
THE UNION PACIFIC RR. CO. AND SOUTHERN PACIFIC TRANS. CO.**

Finance Docket No. 32760, Sub No. 14

**THE TEXAS MEXICAN RAILWAY COMPANY
- TERMINAL TRACKAGE RIGHTS OVER LINES OF
THE HOUSTON BELT & TERMINAL RAILWAY CO.**

**REBUTTAL IN SUPPORT OF THE RESPONSIVE APPLICATION OF
THE TEXAS MEXICAN RAILWAY COMPANY**

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May 14, 1996

REBUTTAL VERIFIED STATEMENT

OF

JOSEPH F. ELLEBRACHT

1. INTRODUCTION

My name is Joseph F. Ellebracht. I am an independent transportation consultant, and I previously submitted a verified statement in support of Tex Mex's responsive application, in TM-23. Two errata statements were also filed in connection with that verified statement. In this statement I will respond to some of the comments made about my verified statement and the Tex Mex responsive application.

2. SUMMARY OF MY PREVIOUS STATEMENT.

My previous statement in TM-23 included the following principal findings and conclusions:

Tex Mex and SP, operating together, have been effective and aggressive competitors to UP for rail traffic to and from Mexico. Shippers of that traffic have benefitted from this competition among U.S. railroads notwithstanding the current state ownership of the rail system in Mexico.

SP has been essential to Tex Mex's ability to serve its international and local markets. Also, the impact of the recent BNSF merger will likely be positive for SP-Tex Mex service, absent a UP/SP merger.

3. UNREBUTTED TESTIMONY

While many comments were made by various parties about my testimony, none of Applicants' witnesses or BNSF's witnesses took issue with the following conclusions that I reached:

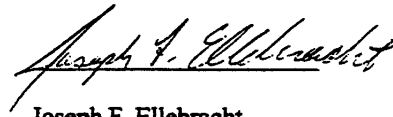
- ▶ The SP-Tex Mex route has been an effective competitor to UP for traffic through Laredo.
- ▶ SP has made extraordinary efforts to develop the Mexican market with Tex Mex, by maintaining a substantial sales force in Mexico, by establishing a special marketing group to eliminate barriers to using the SP-Tex Mex route, and by making substantial investments to help the Mexican railway system develop its capabilities.
- ▶ Truck and water competition are not sufficient to constrain significantly rates for rail transportation between the U.S. and Mexico.
- ▶ Shippers of goods by rail between the United States and Mexico have benefitted from competition between U.S. railroads despite the state ownership of the Mexican rail system.
- ▶ Railroad marketing personnel know that there is generally a range of prices that *may* be charged for rail transportation, due to modal and geographic competition, but the price that *will* be charged is a function of the amount and character of rail-to-rail competition. Railroad marketing personnel are acutely aware of the rail-to-rail competition they face when bidding on significant traffic flows. (The testimony of SP's Mr. Gazzetta, in UP-SP - 231, Volume 2, Part A, shows this awareness very clearly.)

VERIFICATION

I, Joseph F. Ellebracht, certify under penalty of perjury the foregoing is true and correct. Further

I certify that I am qualified and authorized to file this verified statement.

Executed on May 10, 1996.

A handwritten signature in cursive script, reading "Joseph F. Ellebracht", written in black ink.

Joseph F. Ellebracht

PUBLIC VERSION
BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 32760

**UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY
AND MISSOURI PACIFIC RAILROAD COMPANY
-- CONTROL AND MERGER --
SOUTHERN PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC
TRANSPORTATION COMPANY, ST. LOUIS SOUTHWESTERN RAILWAY
COMPANY, SPCSL CORP. AND THE DENVER AND
RIO GRANDE WESTERN RAILROAD COMPANY**

**COMMENTS OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY
AND REQUEST FOR CONDITIONS**

VOLUME I

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Attorneys for The Kansas City Southern
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March 29, 1996

VERIFIED STATEMENT

OF

CURTIS M. GRIMM

FINANCE DOCKET NO. 32760

**UNION PACIFIC CORPORATION, UNION PACIFIC RAILROAD COMPANY
AND MISSOURI PACIFIC RAILROAD COMPANY
-CONTROL AND MERGER -
SOUTHERN PACIFIC RAIL CORPORATION, SOUTHERN PACIFIC
TRANSPORTATION COMPANY, ST. LOUIS SOUTHWESTERN RAILWAY
COMPANY, SPCSL CORP. AND THE DENVER
AND RIO GRANDE WESTERN RAILROAD COMPANY**

I. INTRODUCTION

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

My background includes extensive exposure to public policy issues regarding transportation, including Interstate Commerce Commission ("ICC") merger adjudication. I have previously been employed by the Wisconsin Department of Transportation, the ICC, and the Australian Bureau of Transport and Communication Economics, and I have provided consulting services to several other government agencies and private firms regarding

In short, Baumol and the others have documented that, with very easy entry and exit, a natural monopoly has almost all the attractive characteristics of a competitive market, eliminating the need for regulation. They appropriately call such a natural monopoly a 'contestable' natural monopoly.

VI. RAIL IS THE APPROPRIATE PRODUCT MARKET

In my academic writings and previous ICC testimony, I have consistently argued that rail is the appropriate product market, and that we should reject a market definition that includes other modes within the product market. In determining whether or not a shipper received access to BNSF, Applicants did not consider the type of commodity shipped or the distance the commodity was shipped to the receiver. All 2-to-1 shippers, as defined by Applicants, received BNSF access whether or not the commodity in question may also be easily transported by truck, barge, or air. In other words, Applicants have accepted the notion that the relevant product market was the transportation of products by rail, *i.e.*, reduction of intramodal competition.⁶¹

Focusing on whether or not there is a reduction in intramodal competition, *i.e.*, competition between rail carriers, is entirely consistent with Commission precedent. *SFSP*, 2 I.C.C. 2d 709, 758 (1986)("[T]he relevant product market here is railroad freight transportation. Equally as clear is the necessity . . . for this Commission to assure the continuation of adequate levels of rail intramodal competition."); *BNSF*, slip op. at 59 ("We rest this conclusion primarily upon continued intramodal competition."). *See also* the *UP/MP/WP* case basing the decision largely on econometric estimates of low cross-elasticity

⁶¹ It would be fundamentally unfair to apply a different standard of what constitutes the relevant product market to KCS while at the same time imposing Applicants' proposed conditions which rely on a completely different definition of the relevant product market.

of demand between rail and truck;⁶² and *Chicago, Milwaukee, St. Paul, and Pacific Railroad Company-Reorganization-Acquisition by Grand Trunk Corporation*, 2 I.C.C.2d 161, 224-225 (1984) ("MILW-GTW") (defining the relevant product market as the transportation of freight by rail).

While the Commission has examined whether or not freight transportation by other modes should be included in the same product market as rail freight transportation for the purpose of determining the competitive effects of a proposed transaction,⁶³ the focus of most, if not all, prior merger cases has been the reduction of transportation in the intramodal market. Even in the *UP/MKT* proceeding, where the Commission did consider intermodal and intramodal transportation in defining the relevant product market, the Commission's ultimate conclusion rested on the continued presence of intramodal competition as an effective constraint on rates.⁶⁴ Accordingly, in defining the relevant product market, focusing primarily on intramodal competition is appropriate. The Commission has supported

⁶² *Union Pacific Corporation, Pacific Rail System, Inc. and Union Pacific Railroad Company -- Control -- Missouri Pacific Corporation and Missouri Pacific Railroad Company*, Finance Docket No. 30,000, 366 I.C.C. 459, Appendix E, at 673 (1982) ("UP\MP\WP").

⁶³ *Union Pacific Corporation, Union Pacific Railroad Company and Missouri Pacific Railroad Company -- Control -- Missouri-Kansas-Texas Railroad Company*, 4 I.C.C.2d 409 (1988) ("UP/MKT").

⁶⁴ "We conclude that, post-merger, ample transportation competition will remain throughout the MKT service territory. We rest this conclusion primarily upon continued intramodal competition." *Union Pacific Corporation, Union Pacific Railroad Company and Missouri Pacific Railroad Company -- Control -- Missouri-Kansas-Texas Railroad Company*, et al. 4 I.C.C.2d 409 (1988) ("UP/MKT").

this position in important rail merger cases by rejecting efforts to include motor carrier and barge in its definition of relevant markets.

Although truck competition can supplement inadequate intramodal competition for some products and markets, it is not an effective substitute for rail to rail competition. The relative costs of truck and rail, and thus the extent to which motor carriers are competitive with rail in a particular market, depend on the commodity being transported and the distance between origin and destination.⁶⁵ For longer distances and for movements of bulk products, rail usually has a significant cost advantage. The nature of products, volume and commercial value are factors present that would tend to limit intermodal applications. Furthermore, given that railroads set prices to a large degree individually on a movement-by-movement basis, the fact that some shippers may have truck or source alternatives to a monopoly rail firm for some movements does not help other shippers -- or even those same shippers, for their movements where no competitive alternatives exist.

As will be discussed in more detail below, other modes cannot provide an adequate counterbalance for the diminution of rail competition in the proposed transaction.

VII. TRUCKS WILL NOT PROVIDE AN EFFECTIVE ALTERNATE MODE OF TRANSPORTATION FOR MOST OF THE COMMODITIES INVOLVED IN THE 2-TO-1 AND 3-TO-2 MARKETS

A careful assessment of the record confirms that truck competition is not as pervasive as UP suggests and does not provide a discipline on rail rates for the vast majority of all

⁶⁵ Keeler, Theodore, *Railroads, Freight and Public Policy*, Brookings, Washington, D.C., 1983; *accord* "In evaluating the effect of the consolidation on long-haul movements of bulk commodities, the focus may be on retaining effective intramodal competition." 49 CFR 1180.1(c)(2)(i).

VERIFICATION

Personally appeared the undersigned Curtis Grimm, PhD., who under oath states that the information contained in the foregoing Verified Statement is true and correct.

Curtis Grimm

Curtis Grimm, PhD.

Sworn to and subscribed
before me this 26 day
of March, 1996.

Kathleen M. Lauth

Notary Public

My Commission Expires: 8/1/97

UNION PACIFIC'S CONDITION PROPOSALS

If the Board approves KCS control of Tex Mex, it should impose the following conditions on the Applicants:

1. Applicants must adhere to all of the representations they made during the course of this proceeding, whether or not such representations are specifically referenced in this decision.
2. Applicants must adhere to their commitments in this proceeding that KCS will:
 - a. work cooperatively with UP toward efficient utilization of the Laredo Bridge;
 - b. negotiate in good faith with UP to develop new dispatching protocols for the Laredo Bridge;
 - c. use its control over TFM to ensure that UP and BNSF are provided the same level of service they have experienced in the past and to making improvements to that level of service where possible;
 - d. use its control over TFM to require TFM to cooperate with UP and BNSF on pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars for shipments, accommodating run-through train service, providing excellent service, and promptly quoting rates;
 - e. work with UP and BNSF to develop a methodology for measuring and enforcing service standards for traffic handled by TFM via the Laredo Gateway; and
 - f. keep the Laredo Gateway open on commercially reasonable terms.

Each of these commitments will be enforceable as if it were a condition imposed directly by the Board.

3. To implement the commitment set forth in Condition 2(b), Applicants must negotiate in good faith with UP to develop new dispatching protocols for the Laredo Bridge. Unless the parties agree otherwise, such protocols should provide for (i) a jointly staffed operations center responsible for Laredo Bridge operations, (ii) an express obligation to manage Bridge operations in a manner that is nondiscriminatory and that will achieve maximum efficiency in operation of the Bridge, and (iii) a mechanism for assuring that each U.S. carrier serving the Laredo Gateway has, at any given time, access to Bridge capacity commensurate with the percentage of traffic for which customers have selected that carrier for the movement north of the Laredo Gateway. Applicants shall submit agreed protocols for the Laredo Bridge to the Board within 90 days of the effective date of this Decision. If they have not reached an agreement within that period (or jointly with UP sought additional time for further negotiations), the Board will initiate a proceeding to develop terms that will implement this condition.

4. To implement the commitments set forth in Conditions 2(c)-(e), which will remain enforceable independent of this condition, Applicants must negotiate in good faith with UP to develop an agreement establishing methods for measuring compliance by Applicants with the commitments regarding TFM service and mechanisms for enforcing compliance with those commitments. Applicants shall submit their agreement to the Board within 90 days of the effective date of this Decision. If they have not reached an agreement within that period (or jointly with UP sought additional time for further negotiations), the Board will initiate a proceeding to develop terms that will implement this condition.
5. To implement the commitments set forth in Conditions 2(f), which will remain enforceable independent of this condition, Applicants must negotiate in good faith with UP to develop an agreement to ensure that the Laredo Gateway remains open on commercially reasonable terms. The parties should consider implementing this commitment through an agreement having the in accord with an agreement having the attributes outlined in Appendix C to the Verified Statement of John T. Gray. Applicants shall submit their agreement to the Board within 90 days of the effective date of this Decision. If they have not reached an agreement within that period (or jointly with UP sought additional time for further negotiations), the Board will initiate a proceeding to develop terms that will implement this condition.

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

UNION PACIFIC'S OPENING COMMENTS
ON PROPOSED MERGER RULES

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*Attorneys for Union Pacific Corporation
and Union Pacific Railroad Company*

November 17, 2000

The Board should give merger applicants credit for all proposals that enhance competition. Applicants usually identify enhancements to competition in their applications, and some of those improvements are broader than remedies for competitive harms. For example, UP's agreement with BNSF in the UP/SP proceeding to create two competing rail routes in the West Coast's Interstate 5 Corridor created competition that had never before existed. The Board should not, however, impose new competition on a merger. If competitive harms cannot be addressed and are not offset by sufficient public benefits, the Board should reject the merger.

b. Open gateways

UP agrees with the thrust of the Board's proposal but believes that it does not provide sufficient guidance to potential applicants about what constitutes an "effective plan" for preserving established routes. The Board's proposed rules instead defer developing substantive standards for this rule until the next merger case. UP recommends that the Board consider establishing specific protection for gateways along the lines proposed by UP in Appendix A, pp. 33-34.

V. Shortline and Regional Railroad Issues

UP argued that all of the concerns expressed by shortline and regional railroads could be addressed in the Board's general rules addressing competition and service issues. Appendix A, pp. 36-37. UP notes that the Board's proposed rules appear to adopt this approach. UP also joins AAR's comments addressing shortline and regional issues.

VI. Three-to-Two Issues

UP's Initial Comments. UP asked the Board to affirm that the Board will evaluate on a case-by-case basis the effects of transactions that reduce the number of rail carrier alternatives from three to two. Appendix A, pp. 37-38.

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

UNION PACIFIC'S
COMMENTS AND INITIAL PROPOSALS

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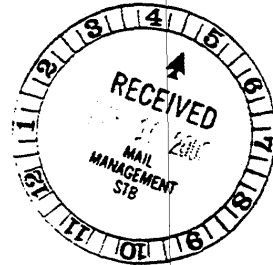
*Attorneys for Union Pacific Corporation
and Union Pacific Railroad Company*

May 16, 2000

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Appendix A

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(4) If the Board grants temporary access and the railroads cannot agree on compensation, the Board will apply compensation standards under 49 U.S.C. §§ 11102 and 11123.

(5) The entity obtaining access must be a rail carrier with operating authority from the Board, and the Board must determine that such carrier can operate safely to address the service problem.

(6) Remedies are available only to shippers lacking existing rail alternatives; provided, however, that the complainant may seek compensation if it can show that the other serving carriers are disabled by the merger-related service problem.

(7) If necessary to effectuate the temporary access remedy, the Board may temporarily suspend a shipper's contractual duty to ship specified volumes of traffic under rail service contracts with the consolidated carrier. The suspension would apply only for the time period necessary to alleviate the service problem.

IV. Promoting and Enhancing Competition

The Board seeks comment on various mechanisms by which rail merger policy might be used to promote and enhance, rather than simply preserve, competition. Most of these mechanisms address the effects of railroad mergers on so-called "bottleneck segments," which are rail segments that connect shipper facilities exclusively served by one carrier with gateways where that carrier connects with other carriers.⁴

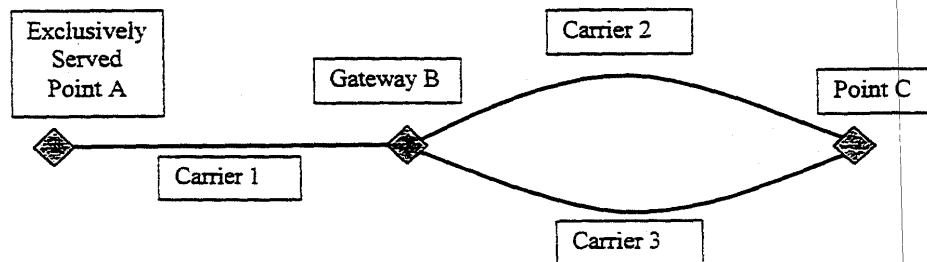
UP does not favor using the Board's jurisdiction over rail mergers to alter the competitive structure of the rail industry other than to address the effects of a merger. UP recognizes, however, that most shippers do not want railroad mergers to affect their

⁴ As the Board's March 31, 2000 decision notes, it is well established that the ICCTA generally does not require rail carriers to establish separately challengeable rates for bottleneck segments. The Board's so-called "Bottleneck" rate decisions clarify the specific circumstances under which carriers may be required to establish, and shippers permitted to challenge, bottleneck rates. See Docket No. 41242, Central Power & Light Co. v. Southern Pac. Transp. Co., Decision served Dec. 31, 1996, clarified in Decision served Apr. 30, 1997, aff'd sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir.), cert. denied, 120 S. Ct. 372 (1999); Union Pacific R.R. v. STB, 202 F.3d 337 (D.C. Cir., 2000).

future opportunities to use established interline routing options. Shippers also do not want mergers either to create new bottlenecks or expand existing bottlenecks. Some shippers are concerned that combinations may eliminate competitive routing options that were previously available for the portion of the overall movement between the gateway and either the origin or destination of the traffic – in effect extending the bottleneck segment. Some shippers are also concerned that, where carriers have established separately challengeable bottleneck rates, a combination with another carrier capable of completing the movement could extinguish the shipper's ability to challenge the bottleneck rate.

UP does not share the view of many shippers that end-to-end mergers generally have anticompetitive vertical effects, and the Board must retain the basic economic and legal principles that guided its Bottleneck decisions. Nevertheless, if the nation's rail system is to be restructured into two transcontinental systems, the Board should take action to keep traditional gateways open. Vague assurances that gateways will stay open are not sufficient because there are too many ways to close them commercially.

UP proposes that the Board modify its rules to require combining carriers to make available at a shipper's request separately challengeable bottleneck rates between exclusively served facilities on their system and the predominant pre-merger gateway for the applicable traffic from those facilities. In the classic "rat-tail" diagram set forth below, if



Carriers 1 and 2 combined, they would be obligated, at the shipper's request, to establish a rate for the "bottleneck" segment between exclusively served Point A and Gateway B. This would preserve the shipper's pre-merger options, because the shipper could combine the A-to-B rate with rates offered by Carrier 3 to complete the movement from origin (Point A) to destination (Point C) and, if necessary, challenge the reasonableness of the A-to-B rate. In fact, such a condition would go somewhat beyond merely preserving the exclusively served shipper's routing options. In some cases, as where the traffic is now moving under joint or proportional rates, the reasonableness of the rate between Point A and Gateway B is not separately challengeable today.

The following specific language for a new section in Part 1180 would implement the proposal outlined above:

1180. __ Preservation of gateways and rate challenge options.

(a) A Class I rail carrier participating as a Primary Applicant in a *major* transaction approved by the Board (a "Participating Carrier") shall, upon request of an affected shipper, establish a rate for transportation (a "Segment Rate") applicable to traffic as to which no Participating Carrier served both the origin and destination of the traffic prior to consummation of the transaction (the "Subject Traffic"), between:

(1) any Exclusively Served Shipper Facility, which means any shipper facility (i) other than an automotive distribution ramp, intermodal facility, or transload facility (ii) that is located at any point on the carrier's system served exclusively by that carrier and no other rail carrier (either directly or via reciprocal switching, joint facility or other service arrangement) (iii) where traffic originated or terminated during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction; and

(2) the Pre-Transaction Gateway, which means the point of interchange, if one exists, that during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction, was (i) an actual interchange between the Participating Carrier and two or more other rail carriers, one of which was another Class I carrier participating in the transaction as a Primary Applicant, (ii) the interchange point most frequently used to move the Subject Traffic (or comparable traffic if the rate

would apply to new traffic) between the Exclusively Served Shipper Facility and the origin or destination of the traffic, and (iii) used by at least 100 cars of traffic originating or terminating at the Exclusively Served Shipper Facility.

(b) The shipper at whose request a Segment Rate is established pursuant to this rule shall be entitled to combine the Segment Rate with a rate or rates offered by a carrier other than the Participating Carrier for movement between the Pre-Transaction Gateway and the origin or destination of the Subject Traffic.

(c) The shipper at whose request a Segment Rate is established pursuant to this rule shall be entitled to challenge the Segment Rate as unreasonably high to the same extent and under the same standards as applicable to rate reasonableness challenges under 49 U.S.C. §§ 10701 and 10707. In determining whether the Participating Carrier is "market dominant," the Board will examine whether there is an absence of effective competition on the entire origin-to-destination route, rather than on the segment between the Exclusively Served Shipper Facility and the Pre-Transaction Gateway.

(d) A shipper facility served exclusively by a Class III rail carrier that is incapable of interchanging traffic with any carrier other than the Participating Carrier, or that is obligated by contract to interchange the majority of its traffic with the Participating Carrier, shall be treated as a facility served exclusively by the Participating Carrier for purposes of this rule. If the Participating Carrier lacks authority to establish a Segment Rate between the Exclusively Served Shipper Facility and the Pre-Transaction Gateway, it shall instead establish a Segment Rate between the point of interchange with the Class III carrier and the Pre-Transaction Gateway.

(e) The obligation to establish a Segment Rate shall also apply to any rail carrier (a "Trackage Rights Carrier") that receives trackage rights or other access to the lines of a Participating Carrier as a result of settlement agreements with the Primary Applicants or conditions imposed on the Primary Applicants by the Board. The Trackage Rights Carrier shall be obligated to establish a Segment Rate pursuant to subparts (a)-(d) above only (1) for traffic capable of being handled using the rights or other access granted to the Trackage Rights Carrier and (2) between Exclusively Served Shipper Facilities located on the Trackage Rights Carrier's system as it existed prior to the transaction and the applicable Pre-Transaction Gateway, if any, where such traffic was interchanged, during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction, with the Participating Carrier over whose lines access was granted.

Such a rule would preserve shippers' pre-merger routing and rate challenge options in a straightforward manner that would not unduly constrain the ability of the combined carrier to achieve efficiencies associated with the combination. Because it would

make use of existing mechanisms for challenging rates, the merging carriers would be able to estimate the costs of this condition in advance. And the condition would ensure that the major pre-transaction gateways would remain open.⁵

This approach is preferable to the options suggested by the Board:

- The Board's contract option would require the shipper to carry the burden of negotiating an agreement with the non-merging carrier on rates and all other attributes of the transportation. That commercial agreement might not be reached.
- The Board's through route alternative would require the merged carrier and connecting carriers to agree. Again, they might not reach agreement.
- The Board's reciprocal switching and trackage rights proposals would run afoul of the fundamental policy basis for the Board's Bottleneck decisions, which affirmed bottleneck carriers' traditional routing discretion and statutorily-recognized right to select their long-hauls.⁶ Those proposals would go far beyond what is needed to offset effects of the merger.

No new rule should require the merged carrier to short-haul itself, depriving the carriers of the returns upon which they depend to attract capital, reinvest in their rail networks, and maintain and improve service.

⁵ Our proposed rule clarifies that the existence of transportation alternatives providing effective competition will be evaluated with respect to the entire movement from origin to destination, which is the transportation service of interest to the shipper. This will avoid the anomalous outcomes that would result were market dominance determinations based on competition for the bottleneck segment only, for example where intermodal competition between origin and destination provides a competitive constraint on rail rates but does not exist at a remote rail gateway where there is no reason at all for competition to exist. See, e.g., STB Docket No. 42038, Minnesota Power, Inc. v. Duluth, Missabe & Iron Range Ry., Decision served July 8, 1999 (ignoring rail-truck alternative between coal mine and utility because there was no evidence of transportation competition at interchange point).

⁶ Docket No. 41242, Central Power & Light Co. v. Southern Pac. Transp. Co., Decision served Dec. 31, 1996, pp. 4-11.

Our rule is also far superior to the long-discredited “DT&I” conditions. Those conditions imposed draconian and inefficient requirements to allow routing over all possible gateways and required rate and service parity regardless of the relative efficiencies of various routes. Any such requirement would create significant impediments to efficiency.

UP’s proposed rule would supplement existing precedent governing Board analysis of the potential vertical competitive effects of proposed rail combinations.

The Board has not established a hard-and-fast rule that end-to-end combinations can never have anticompetitive effects. Rather, the Board’s so-called “one-lump” theory establishes a presumption that end-to-end mergers do not have such effects. The presumption can be rebutted, and shippers can seek additional remedies. See, e.g., Finance Docket No. 32549, BN/Santa Fe, Decision No. 38, served Aug. 23, 1995, p. 71, aff’d, Western Resources, Inc. v. STB, 109 F.3d 782 (D.C. Cir. 1997).

V. Shortline and Regional Railroad Issues

All of the concerns expressed by shortline (Class III) and regional (Class II) railroads (collectively, “smaller railroads”) can be addressed by the Board’s general rules addressing competition and service issues. The service and bottleneck rate protections set forth in other new rules that UP has proposed would provide significant protections for Class III railroads and the shippers they serve. Additional rules specifically addressing shortline issues are not needed.

In particular, concerns regarding the appropriateness of contractual limits on interchange (sometimes called “paper barriers”) are not the proper subject of general merger rules. The underlying contractual obligations did not arise from mergers and often are unaffected by mergers, particularly on UP. Issues relating to such contractual provisions were addressed in Ex Parte No. 575, Review of Rail Access and Competition Issues, and

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Comments Exhibit 21
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July 30, 2003

BY HAND

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Dear Bill:

This letter responds to questions regarding UP's position raised in your July 21 letter.

First, you ask what UP means when it says that it does not oppose the creation of NAFTA Rail "if the NAFTA Rail carriers agree not to discriminate against UP traffic at the International Bridge at Laredo, and if TFM continues to support competitive UP-TFM service and rates." I believe that UP has made its position clear in a number of settings, but I am happy to respond to your specific questions:

- a. "What do you mean by 'not discriminate?'"

UP's Response: By seeking protections to ensure that NAFTA Rail carriers "not discriminate," UP refers to any step that Tex Mex or TFM might take that would inappropriately favor TFM-Tex Mex traffic over UP-TFM traffic at the Laredo Bridge. One example of such discrimination would be efforts by Tex Mex and TFM to limit UP to 50 percent of the Bridge's capacity when more than 50 percent of Laredo traffic volumes were moving on UP routes north of Laredo.

- b. "As you know, operations at the Bridge are governed by a series of agreements dating back to 1951 and KCS has committed to abide by such agreements. Does UP contend that such agreements currently "discriminate" against UP?"

UP's Response: UP believes that existing agreements may be open to multiple interpretations, but since TFM's creation have not been applied in a discriminatory way. However, those agreements contain inadequate protections against potential discriminatory

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Page 2

behavior by Tex Mex and TFM once their incentives change due to KCS's acquisition of control of Tex Mex and TFM.

- c. "If UP believes the agreements discriminate against it, why has UP not sought to enforce its rights under those agreements, rather than seek STB intervention over purely private contacts?"

UP's Response: As noted above, the problem is not existing discrimination, but the change in incentives caused by KCS's acquisition of control. In the past, when Tex Mex was controlled by TFM rather than KCS (and when TFM was controlled by Grupo TMM rather than KCS), Tex Mex carried out TFM's interest in maximizing rail traffic moving via Laredo regardless of which U.S. carrier handled it north of the border. KCS, by contrast, will have incentives to discriminate against UP-TFM traffic.

- d. "What does UP mean by 'competitive UP-TFM service and rates'?"

UP's Response: "Competitive UP-TFM service and rates" refers to UP-TFM rates and service offerings that reflect continued cooperation from TFM rather than efforts by TFM (under KCS control) to tilt the competitive playing field in favor of KCS/Tex Mex by causing UP-TFM options to become less attractive to customers.

- e. "By 'competitive UP-TFM service and rates,' does UP believe that TFM should give UP the exact same divisions as it would give KCS and Tex Mex?"

UP's Response: No, UP does not propose that TFM should be required to give UP the exact same divisions as it would give KCS and Tex Mex. In fact, a requirement of equal divisions would not protect competition following KCS's acquisition of control because Nafta Rail could manipulate upward the TFM portion of its origin-to-destination rates, thereby rendering UP-TFM service offerings unattractive to shippers, while lowering the KCS/Tex Mex portion.

Applicants have committed in this case to keep the Laredo Gateway open on "commercially reasonable terms," but they have not provided any explanation of what terms they would regard as "commercially reasonable" or how their commitment would otherwise be implemented. UP believes the concept of "commercially reasonable terms" requires definition, and UP would be open to a number of potential ways of ensuring that shippers continue to have access to reasonably-priced UP-TFM services.

Second, you inquire about UP's position that UP and its customers should receive a share of Laredo Bridge capacity "commensurate with their share of the rail traffic crossing the Bridge."

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- a. "By this suggestion, is UP claiming that if, for example, it currently has 80% of the market share for U.S./Mexico traffic at Laredo that it should be guaranteed the right to use the Bridge 80% of the time?"

UP's Response: No. UP is not seeking to lock in its current share of traffic moving via Laredo. If UP's share of traffic declines because Tex Mex wins more business, UP's allocation of Laredo Bridge capacity should decline commensurately. UP's position is that, at any given point in time, it should be allotted a share of Laredo bridge capacity equivalent to whatever share of traffic is moving in UP-TFM service via Laredo. Tex Mex and TFM should not be in a position to impose artificial constraints on UP's access to Laredo Bridge capacity by, for example, insisting that UP receive only 50 percent of the Bridge's capacity at a time when its share of traffic exceeds 50 percent. UP is prepared to discuss how best this principle could be implemented.

- b. "If KCS were to guarantee UP's use of the Bridge based upon UP's current market share usage over the Bridge, how would KCS ever be able to increase its market share for U.S./Mexico traffic?"

UP's Response: The question misstates UP's position. As explained above (in response to item 2(a)), if KCS increased its market share, it would be entitled to a larger share of Laredo Bridge capacity.

- c. "Under this suggestions [sic], wouldn't UP have 'locked-in' the Bridge's capacity so as to prevent NAFTA Rail from increasing their use and from being able to effectively compete against UP?"

UP's Response: There would be no "lock-in," for the reasons explained in 2(a) above.

Third, you ask what UP means when it says that TFM should not "discriminate against" UP connecting traffic in favor of Nafta Rail carriers with respect to service.

- a. "What does UP mean by the word 'discriminate?'"

UP's Response: UP believes that this concept is quite straightforward. Under KCS control, TFM should cooperate with UP in providing existing levels of service on UP-TFM movements and working to improve those services, to the same extent that it cooperates with its Nafta Rail partners, unless circumstances (such as the relative volume of traffic) warrant different treatment. UP desires to impose no limitations on the degree to which TFM could cooperate with its Nafta Rail partners.

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Fourth, you ask about UP's statement that KCS should use its control of TFM to cause TFM to continue providing UP with "equitable TFM rate factors."

- a. "Please confirm that UP is requesting that TFM provide it with rates/divisions from or to the Laredo Gateway for only the TFM portion of the entire rail move."

UP's Response: There may be many ways to implement Applicants' commitment to keep the Laredo Gateway open "on commercially reasonable terms," not all of which would necessarily involve TFM rates or divisions. If Nafta Rail were to elect to keep the gateway open by making enforceable commitments regarding TFM's rates or divisions, UP confirms that the TFM rates or divisions would necessarily cover the portion of the movement on TFM's system, *i.e.*, between Laredo and the Mexican point served by TFM or its connections within Mexico.

- b. "Please confirm that even if a rail movement could originate and terminate on NAFTA Rail (meaning a commonly controlled KCSR, Tex Mex, and TFM) that UP is still requesting that NAFTA Rail provide it with a rate/divisions requirement for only the TFM portion of the movement?"

UP's Response: See my response to item 4(a), above. If Nafta Rail were to agree with UP to keep the gateway open by making enforceable commitments regarding TFM's rates or divisions, UP believes that it would be especially important that such commitments apply to TFM rates or divisions for movements as to which UP and KCS/Tex Mex compete. If such commitments did not apply in those situations, competition would be extinguished.

- c. "If a UP-TFM routing competes against a KCSR/Tex Mex/TFM routing, would UP consider the TFM portion of the route to be the 'bottleneck segment?'"

UP's Response:

UP is uncertain what meaning you intend by your use of the phrase "bottleneck segment," which has been used in different ways in different contexts by various parties. UP does believe that for a large portion of the traffic moving between the United States and Mexico via the Laredo gateway, the TFM portion of the route is an indispensable element of any competitive origin-to-destination transportation service offering, in part due to excessive trackage rights charges in Mexico.

- d. "Is UP requesting KCS to provide UP with the same or 'equal' rates over the TFM bottleneck segment that KCS would provide itself over TFM?"

UP's Response: Not necessarily. See my response to item 1(e), above.

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William A. Mullins, Esq.
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Page 5

- e. "Please confirm that if KCS is required to provide UP with 'equitable' rates at Laredo for the TFM portion of an entire origin/destination through route to/from the U.S. to Mexico that such a requirement would prevent NAFTA Rail from providing long haul pricing and instead would require NAFTA Rail to 'short haul' itself for the TFM portion of the move?"

UP's Response: UP is not seeking to prevent KCS from offering "long haul pricing." KCS should be free to price KCSR-Tex Mex-TFM movements as it wishes to attract traffic to its Nafta Rail system, and to lower those rates to reflect any efficiencies that KCS control might achieve. However, KCS should not force shippers to use less efficient long hauls on the Nafta Rail system by extinguishing competition provided by UP-TFM options, such as by establishing non-competitive TFM rate factors.

- f. "For any location where UP currently has the ability to interchange with KCSR or Tex Mex, but interchanges with other carriers instead, is UP willing to give KCS the same rates/divisions that it gives to other carriers at that location?"

UP's Response: No, just as UP is not proposing that KCSR or Tex Mex provide UP with the same rates/divisions that it gives other carriers.

Also, your question is not germane to the competitive concerns raised by KCS's acquisition of control of Tex Mex and TFM. Applicants have made a commitment in this case to keep the Laredo Gateway open on commercially reasonable terms. As discussed above, implementing that commitment may or may not involve commitments respecting TFM's rates or divisions. But the need for some form of concrete and enforceable commitment arises in this case – but does not arise with respect to other existing interchange situations – because KCS control will adversely affect competition via the Laredo Gateway. .

Fifth, you ask several questions about the concept of "neutrality and non-discrimination."

- a. "When UP speaks of 'neutrality' are they talking about neutral TFM rates (divisions) at the Laredo Gateway?"
- b. "Does 'neutral' TFM rates mean 'equal' TFM rates – equal as being between UP and KCSR/TFM?"

UP's Response to (a) and (b): No. See my response to item 1(e), above.

- c. "If UP does not mean neutral TFM rates between KCSR/Tex Mex and UP, then what commitment of 'neutrality' is UP referring to?"

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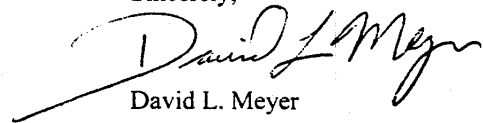
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July 30, 2003
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d. "What 'non-discrimination' commitment is UP referring to in this section?"

UP's Response to (c) and (d): UP is referring to neutrality and non-discrimination with respect to the operation of the Laredo Bridge and the entire array of TFM cooperative steps on matters of interline service that have heretofore provided shippers with attractive UP-TFM transportation options via the Laredo Gateway, and which would continue to do so absent KCS's acquisition of control of Tex Mex and TFM. UP's concept of non-discrimination is described further in my response to item 3(a), above.

Finally, you suggest that UP's positions appear contrary to previous positions UP has taken before the Board and Congress. UP disagrees, as our comments in the Board's Class 1 merger rules proceeding confirm. UP will be explaining in its August 4 Comments in this proceeding why its request for Board conditions in this case is supported by existing Board precedent and Congress' rail transportation policies.

Sincerely,



David L. Meyer

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William A. Mullins, Esq.

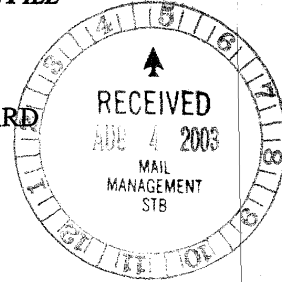
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BEFORE THE
SURFACE TRANSPORTATION BOARD



Finance Docket No. 34342

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

UNION PACIFIC RAILROAD COMPANY'S COMMENTS

VOLUME 2 of 2: VERIFIED STATEMENTS

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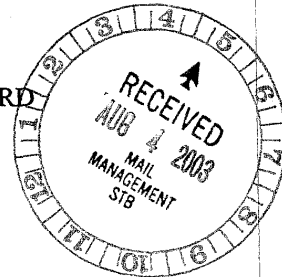
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PUBLIC VERSION

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 34342

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



VERIFIED STATEMENT

OF

JOHN T. GRAY

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VERIFIED STATEMENT

OF

JOHN T. GRAY

My name is John T. Gray. I am Executive Director, Interline for Union Pacific Railroad Company ("UP"). In this capacity I am responsible for analysis of strategic issues and interline relationships with other Class I railroads and short lines. Previously, I was UP's Vice President and General Manager, Business Development. In this position I was responsible for interline management, and industrial development, as well as UP's Mexico business group. Prior to that I was Vice President and General Manager of UP's Industrial Products Business Unit with responsibilities for a business line with approximately \$2 billion in annual revenue.

I came to Union Pacific in 1996 as a result of the UP/SP merger. Prior to the merger, I served as SP's Vice President-Network and Corporate Development. In that position I was responsible for SP's Service Design and Planning group, Joint Facilities and Operating Contracts, Strategic Analysis and Capital Planning. During 1995 and 1996 I managed SP's activities associated with the merger of SP and UP.

After earning a Bachelor's degree in Civil Engineering and a Master's degree in Civil Engineering from Tulane University, I served in the Army as executive officer of a transportation unit. I then took Ph.D. courses in transportation systems analysis and developed railroad cost models as a Research Assistant in the Transportation Center at Northwestern University. As Assistant Professor of Transportation at the University of Alaska, I subsequently taught transportation courses and developed transportation analysis tools.

I began my railroading career as Manager-Marketing and Sales for The Alaska Railroad. I later became the Director of Transportation for ARCO Alaska, Inc. I then spent five years at BN, first as Director-Marketing and Business Analysis and later as Assistant Vice President-Chemicals. I moved to SP in 1992 as Managing Director-Yield Management. I was promoted to Vice President-Network and Corporate Development in 1994.

I. INTRODUCTION AND SUMMARY

I explain in this statement why Kansas City Southern's ("KCS's") proposed control of The Texas Mexican Railway ("Tex Mex"), in conjunction with its acquisition of control of the most important Mexican railroad, Transportación Ferroviaria Mexicana ("TFM"), poses serious threats to competition for U.S.-Mexico rail shipments. Unless appropriately conditioned by the Board, KCS's proposed transaction will impair the competitive options available to shippers at the vital Laredo Gateway.

In 1996, the Board recognized that "Laredo is the principal rail gateway between the United States and Mexico,"¹ and it imposed conditions aimed at preserving effective two-railroad competition north of the border for U.S.-Mexico rail traffic moving via Laredo.² Laredo's importance is even greater today. International rail traffic via Laredo has more than doubled since 1995, far outpacing growth at other eastern Mexico rail gateways.

The Board's vision of effective two-carrier competition at Laredo has been achieved. TFM has worked closely with both UP and Tex Mex to develop highly efficient cross-border rail transportation services. Although shippers have chosen efficient UP-TFM

¹ *Union Pacific Corp., et al. - Control & Merger - Southern Pacific Rail Corp.*, 1 S.T.B. 233, 410 (1996).

² The Board granted Tex Mex extensive trackage rights over UP, allowing Tex Mex to connect with KCS at Beaumont. *See id.* at 422-25.

routes for the great majority of traffic flowing across the border via Laredo, by working with both KCS and BNSF, Tex Mex has increased its international traffic by almost { } percent since 1995.

Effective competition for rail traffic moving via Laredo depends on the cooperation of *both* Tex Mex and TFM. First, Tex Mex (with its parent Mexrail) controls the northern half of the Laredo International Bridge, which is the critical facility that all international rail traffic must use to cross the Rio Grande River at Laredo.³ Second, TFM is the only Mexican carrier serving the Laredo gateway. KCS regards TFM and its Laredo-Mexico City main stem as the “the crown jewel system in Mexico.”⁴ The only way for UP to offer interline transportation services over the Laredo gateway – and thus the only way for the Laredo Gateway to be “open” – is with the cooperation of TFM.⁵

UP does not oppose efforts by KCS to become a more effective competitor and in the process attract additional U.S.-Mexico traffic via the Laredo Gateway. UP is not participating in this case out of a concern that KCS might become more efficient. Based on Applicants’ statements about their plans for TFM – which involve KCS’s acquisition of control but no operational changes – the prospect of significant improvements seems unlikely. To the extent the proposed KCS-Tex Mex-TFM transaction makes “NAFTA Rail” routes (or TFM-Tex Mex-BNSF routes) more efficient, UP would regard those changes as

³ As Mr. Barkley explains, UP can only reach the Mexican border by using trackage rights over Tex Mex.

⁴ KCS Conference Call with Analysts (April 29, 2003) (included as an Exhibit to UP’s Comments).

⁵ A map of the proposed KCS-Tex Mex-TFM system, which depicts the lines of TFM and other railroads within Mexico, is Exhibit A hereto.

procompetitive, even if UP loses traffic and revenues in the process. In any event, none of the relief UP is seeking in this case would interfere with KCS's ability to achieve efficiencies by combining KCS, Tex Mex and TFM into a single, commonly controlled system.

The reason UP is participating in this case is because, in the unique circumstances present here, unconditioned KCS control of Tex Mex and TFM poses serious dangers to competition. When KCS gains control of Tex Mex and TFM, these carriers will have new incentives and new abilities to distort the competitive playing field for traffic moving via the Laredo Gateway between TFM-served points and points in the United States and Canada. KCS actions based on those incentives are likely to eliminate rather than enhance competition. As I will explain, KCS will have incentives to increase the collective profits of its controlled entities by raising rates to shippers and rendering the efficient UP-TFM options that many shippers now prefer more costly, less efficient and thus less attractive.

Applicants have made three commitments on the record in this proceeding. They represent that: (1) KCS will treat UP fairly at the Laredo Bridge; (2) KCS's TFM subsidiary will continue to work with UP for movements via Laredo; and (3) KCS will keep the Laredo Gateway open on commercially reasonable terms. These commitments reflect a proper recognition of the Board's role in safeguarding rail competition via the Laredo Gateway. At the very least, the Board should impose KCS's commitments as conditions in this case. However, KCS's commitments by themselves do not offer sufficient protection. Although aimed at the right problems, Applicants' promises are not sufficiently concrete or enforceable.

UP therefore asks the Board to implement KCS's three commitments by doing three simple things:

1. The Laredo Bridge: Impose a condition requiring KCS to work with UP to reach an agreement respecting new protocols governing operation of the Bridge (as it has already committed to do). The need for such a condition is discussed in the verified statement of Stephen R. Barkley.
2. TFM Service: Impose a condition requiring KCS to develop an agreement that establishes methods for measuring compliance by Applicants with their commitments regarding TFM service and methods for enforcing those commitments. This is also something that Applicants have already committed to do, but it should be done under Board auspices for the reasons I explain below.
3. Keeping the Laredo Gateway Open Commercially: Impose a condition requiring KCS to develop an agreement with UP to ensure that Applicants live up to their commitment to "keep the Laredo Gateway open on commercially reasonable terms." The critical feature of any such agreement would be a mechanism for assuring that the commercial terms of TFM's participation in international rail service offerings (e.g., rates, rate factors, etc.) would allow joint UP-TFM international rail services to remain competitive. There may be many ways to implement this condition effectively, as I explain below.

UP's proposed conditions are carefully tailored to permit KCS, Tex Mex and TFM to develop and capitalize on their potential single-system efficiencies, while preserving the effective competition for U.S.-Mexico traffic among U.S. railroads north of the border that shippers enjoy today.

II. KCS CONTROL OF TFM AND TEX MEX THREATENS TO UNDERMINE EFFECTIVE COMPETITION FOR U.S.-MEXICO RAIL TRAFFIC

As explained below, KCS control of TFM and Tex Mex is likely to undermine effective competition for U.S.-Mexico rail traffic.

A. Rail Transportation Plays a Vital Role in Trade between Mexico and Its NAFTA Trading Partners

As a result of the North American Free Trade Agreement and the privatization of Mexico's rail system, U.S.-Mexico rail traffic has grown dramatically. Since 1994, total cross-border rail traffic has increased by 158 percent to account for nearly \$31 billion in

international trade between the U.S. and Mexico.⁶ Privatization of the antiquated, government-owned system brought massive investment in Mexico's rail infrastructure, tremendous improvement in the operating efficiency of Mexico's railroads, and increasingly effective cooperation between those railroads and their U.S. interchange partners north of the border. For example, since 1996 TFM has spent \$1 billion on capital improvements, completely overhauling its mainline and building five completely new intermodal facilities. It has shed thousands of workers and invested in over 150 efficient new locomotives. TFM revamped its operations, and has begun offering innovative services. Among other things, TFM now cooperates with its U.S. connections to operate efficient 100-car unit "shuttle trains" that move grain from U.S. producers to major Mexican receiving points, replacing the former system of handling this traffic one car at a time at a much higher cost. As a result of such steps, TFM has lowered its operating ratio from 93.6 percent when it began operations in 1997 to 76.1 percent in 2002.⁷

Because of improvements like these, rail transportation has become the mode of choice for growing numbers of companies engaged in trade between Mexico and the rest of North America. Rail increasingly offers those shippers significant cost and/or service advantages relative to other transportation options. For many rail shippers of bulk commodities to or from points not served by water, of course, rail has been and remains effectively the only option.

⁶ See Bureau of Transportation Statistics, "U.S. Merchandise Trade with Mexico by Rail, April 1993-December 2002" (available at http://www.bts.gov/ntda/tbscd/reports/us_mex_2002_Rail.html) (Exhibit B hereto).

⁷ See Post-Effective Amendment No. 2 to Form F-4, Registration Statement under the Securities Act of 1933, Grupo TMM, S.A. and TMM Holdings, S.A. de C.V., Apr. 23, 2003, at 95 (excerpts are Exhibit C hereto).

B. The Laredo Gateway Is Increasingly Vital to U.S.-Mexico Rail Traffic

In the arena of U.S.-Mexico rail traffic, the Laredo gateway has unique importance for rail traffic between Mexico and the United States (and Canada). In 1996, when the Board acted to preserve effective two-railroad competition via Laredo, it recognized Laredo's important role in cross-border rail commerce. Laredo has become even more important in the past six years.

1. Shippers' Routing Choices Reflect Laredo's Importance

The clearest indication of the vital role the Laredo gateway plays in U.S.-Mexico trade is the vast amount of rail traffic handled there. Rail traffic moving via Laredo accounts for approximately 75 percent (by dollar value) of all rail traffic between the United States and Mexico.⁸ However, even this figure greatly understates Laredo's importance. Geography plays an important role in limiting most shippers' gateway options. For example, movements between UP's points in the western United States and points in western Mexico naturally flow via the three gateways in western Mexico: Calexico, Nogales and El Paso. Traffic between points in the central and eastern United States (and Canada) and points in eastern and central Mexico cannot effectively use these western gateways.

Of the three gateways in eastern Mexico – Laredo/Nuevo Laredo, Eagle Pass/Piedras Negras and Brownsville/Matamoros – Laredo is preferred by the vast majority of shippers. Laredo accounted for 86 percent of the rail traffic (by value) moving via these three

⁸ The figure is based on 2001 Bureau of Trade Statistics data on the value of shipments moving between the United States and Mexico. See Bureau of Transportation Statistics, U.S. International Trade and Freight Transportation Trends 2003, "Table 24: Top 10 U.S. Land Ports by Value of U.S.-NAFTA Surface Trade: 2000 and 2001" (available at http://www.bts.gov/publications/us_international_trade_and_freight_transportation_trends/2003/html/table_24.html) (Exhibit D hereto).

gateways.⁹ Data on the carloads crossed at these gateway tells the same story. In 2002, Laredo accounted for more than { } of all traffic moving via these gateways, as shown in Exhibit E. Eagle Pass, where UP and BNSF connect with Ferromex, handled only { } percent of the loads crossing the border in eastern Mexico.¹⁰ Brownsville, where UP and BNSF connect with TFM, handled only { } percent of the loads. Brownsville's role is quite limited, because it is deficient in all of the attributes that make Laredo important. For example, Brownsville has few brokers and weak border infrastructure. Routes via Brownsville are quite circuitous for shipments to most of the central and eastern Mexico and the capacity of TFM's secondary line from Matamoros to the south is quite limited as is the capacity of UP's line south of Robstown, Texas. For these reasons, most of the traffic moving via Brownsville is traffic to and from *maquiladora* plants near Matamoros and other points just across the border from Brownsville in the Mexican states of Tamaulipas and eastern Nuevo Leon, which cannot be reached as efficiently via Laredo or other gateways.¹¹

Even these figures understate Laredo's importance. For certain markets such as for traffic moving between the eastern and midwestern United States and eastern Canada and the industrialized regions of central and eastern Mexico, UP's data indicates that Laredo accounts for even higher shares of all rail traffic, frequently well above { } percent. For example, Laredo handles over { } percent of all UP movements from origins in Michigan

⁹ *Id.*

¹⁰ I discuss the reasons for Eagle Pass' limited role at pages at page 16, below.

¹¹ See Map at Exhibit A. In addition, as noted below, UP and TFM use Brownsville for empties that would ordinarily move via Laredo in order to maximize the efficiency of both gateways.

and Illinois (the two largest origins for Mexican rail traffic) to destinations in Mexico Distrito Federal (Mexico City) and the industrialized Mexican states of Puebla and Querétaro.

Another useful perspective is the rate of growth in rail traffic via Laredo. The volume of traffic moving across the Laredo Gateway has more than { } since 1995, as shown in Exhibit F. Tex Mex, strengthened by the Board's grant of trackage rights in the *UP/SP* case, has increased its volume of Laredo traffic nearly { } fold. *Id.*

At the same time, Laredo has also grown in importance relative to the other border crossing gateways. In 1995, as today, the principal alternative to Laredo was Eagle Pass/Piedras Negras. In 1995, Laredo accounted for { } percent of the total cross-border loads at these two gateways. By 2002, Laredo's share had grown to { } percent.¹²

Laredo's growing importance is perhaps best reflected in the fact that UP has seen its greatest growth occur at Laredo despite having acquired a 26 percent ownership interest in Ferromex, the sole Mexican railroad serving Eagle Pass. In 1995, Eagle Pass accounted for { } percent of UP's and SP's total cross-border loads at the Laredo and Eagle Pass gateways.¹³ In 2002, Eagle Pass's share of UP's loads via these two gateways had fallen to { } percent.¹⁴

2. Laredo Has Significant Advantages Over Other U.S.-Mexico Gateways

Laredo's importance stems from several factors. In part Laredo's advantages are due to the relative efficiency of the U.S. rail routes serving Laredo from the north. But

¹² See Exhibit F.

¹³ In 1995, UP handled { } loads via Laredo; SP handled { } loads via Laredo in conjunction with Tex Mex and { } via Eagle Pass.

¹⁴ In 2002, UP handled { } loads via Laredo and { } via Eagle Pass. (BNSF handled { } loads).

that is a relatively small factor. Laredo's principal advantages over other Mexico gateways are three:

- (1) Laredo has a uniquely well-developed international border crossing infrastructure – including well-developed facilities and procedures for customs and other governmental services, a strong broker community, and an extensive rail infrastructure that supports the special requirements of efficient international rail border crossings;
- (2) TFM's network serving Laredo from the south offers significant advantages. These include TFM's highly-efficient direct route between the border and the industrial centers of San Luis Potosí and Toluca, which it serves exclusively, as well as Monterrey, Querétaro, Mexico City and other points in the industrialized heartland of northeastern and central Mexico; and
- (3) TFM offers well developed and very efficient rail transportation services in close cooperation with both of its interline partners, UP and Tex Mex.

a) Laredo's Extensive Border Infrastructure

As a result of its central role in U.S.-Mexico cross-border trade, Laredo now has a uniquely well-developed infrastructure to accommodate the efficient handling of large volumes of international rail traffic. This infrastructure is the result of many years of planning and investment by the U.S. and Mexican governments, by the railroads serving Laredo, and by third party brokers, warehousing firms, and others that have located at Laredo. These investments were made not just because of Laredo's important role in cross-border rail

transportation, but because of its importance for truck transportation as well. Laredo is by far the leading crossing point for U.S.-Mexico trade by all surface modes.¹⁵

At any high-volume international crossing point, a well-developed infrastructure is essential to accommodate the need for customs, agricultural, narcotics and immigration inspections. The number of inspections has grown significantly with heightened scrutiny at international border crossings since 9/11. As a result of investments by governments and railroads, Laredo has unusually efficient inspection processes. While still time consuming, these processes have helped to expedite clearance at the border and significantly improve the fluidity of train movements between the United States and Mexico.

Customs, agricultural and other inspection forces of both countries are on duty 24 hours a day at Laredo to facilitate prompt movement of rail traffic. In 1999, UP installed a state-of-the-art, \$1.5 million federal customs inspection facility at its Port Laredo yard. The UP facility has a support building for offices of Customs, USDA, and other federal agencies. It also contains a secure location for federal agency personnel to inspect up to sixteen rail cars and eight over-the-road trailers at a time. UP has installed facilities that allow it to switch out cars for inspection while minimizing delays to other movements. U.S. Customs has also invested in facilities for x-raying railcars, the high-tech Vehicle and Cargo Inspection System ("VACIS"), to facilitate detection of illegal immigrants and, especially since 9/11, to assist U.S. government anti-terrorism efforts. Tex Mex also invested a quarter of a million dollars

¹⁵ In 2001, Laredo accounted for over \$79 billion of U.S.-Mexico surface trade (both highway and rail). Eagle Pass was a distant eighth, with \$6.7 billion of total cross-border commerce. See Bureau of Transportation Statistics, U.S. International Trade and Freight Transportation Trends 2003, "Table 24: Top 10 U.S. Land Ports by Value of U.S.-NAFTA Surface Trade: 2000 and 2001" (available at http://www.bts.gov/publications/us_international_trade_and_freight_transportation_trends/2003/html/table_24.html) (Exhibit D hereto).

to support this system. TFM has recently opened a SAGAR (the Mexican equivalent of USDA) post at its Sanchez Yard in Nuevo Laredo.

Cross-border shippers (rail and truck) also require extensive support from brokers and other third parties, such as freight forwarders, in dealing with the customs clearance process. Customs brokers and freight forwarders assist shippers in preparing customs forms for the U.S. and Mexican authorities. They utilize electronic pre-clearance procedures that have been implemented by customs agencies on both sides of the border. Laredo has a uniquely well developed broker community, in large part because it is also a very important crossing point for international highway traffic. Compared to other rail crossings, Laredo has a far greater concentration of brokers and freight forwarders. For example, Eagle Pass has only 15 U.S. brokers and 40 freight forwarders, whereas Laredo has 160 U.S. brokers and 500 freight forwarders.

The railroad infrastructure in the vicinity of Laredo is equally important. Although the railroads' pre-cleared run-through services at Laredo are relatively efficient, the railroads still must have extensive rail infrastructure for staging trains and railcars as they await inspection and customs clearances and access to the International Bridge. As a result of millions of dollars of investment by UP, TFM and Tex Mex, Laredo is uniquely positioned to handle high volumes of cross-border rail traffic. Mr. Barkley describes some of the changes UP and the other railroads have made in recent years to facilitate the efficient operation of the Laredo Bridge. All three railroads have built and expanded rail yards to support the growth of traffic moving through Laredo and to maintain the fluidity of the Laredo Bridge operation. At UP's Port Laredo facility, for example, UP has implemented nine phases of expansion since 1990, including the addition of sixteen classification tracks and an intermodal yard. UP and

TFM have also added to mainline track capacity in order to support Laredo crossing operations. For example, UP recently spent \$ { } installing an additional siding on its line between Port Laredo and the Laredo Bridge.

UP estimates that the rail infrastructure at Laredo is currently capable of handling approximately { } trains per day across the border. At Eagle Pass, by contrast, UP estimates that there is sufficient capacity to cross only { } trains per day. Significant investments in both railroad and customs-related infrastructure would have to occur for Eagle Pass to be capable of handling volumes of traffic that approach those currently moved via Laredo. In the recent past the Eagle Pass gateway has operated close to capacity. Furthermore, the Mexican customs office at Eagle Pass has limited weekend hours, and Eagle Pass lacks the extensive supporting infrastructure the railroads have developed at Laredo. Regulatory constraints also make it difficult to put in place the required customs support services at Eagle Pass. Mexican law limits customs brokers to no more than four locations. Thus, many brokers that would open a new outlet at Eagle Pass may be required to close an existing location at another border crossing.

b) TFM's Routes South of Laredo Offer Significant Advantages

Another significant advantage favoring the Laredo Gateway is the fact that, unlike Eagle Pass, it provides access to TFM's route network. FXE and TFM were formed following the Mexican government's decision to privatize its national rail system in the mid-1990's. FXE operates primarily in western Mexico, while TFM holds what was referred to at the time of privatization as the "Northeast Concession." See Map at Exhibit A. TFM lines run from the Laredo and Brownsville gateways south into the most populous and industrialized regions of Mexico. TFM directly serves leading rail freight centers in Mexico,

including: Monterrey, Saltillo, San Luis Potosí, Querétaro, Mexico City, and Veracruz. *See* Exhibit A, and TFM's System map (Exhibit G hereto).¹⁶

FXE's lines are predominantly in the western part of Mexico. While FXE and TFM both serve a number of the same Mexican points, TFM's route has geographic advantages for movements between eastern Mexico gateways and much of eastern and central Mexico. A comparison of the TFM and FXE routes between the border and the area surrounding Mexico City, Mexico's largest population and consumption center, is illustrative. FXE's route between Eagle Pass and Mexico City is approximately 407 miles longer than the TFM route between Laredo and Mexico City.¹⁷ Using trackage rights over TFM (between a point near Saltillo and Querétaro, as shown on the map), FXE can narrow that differential to 48 miles, but FXE's trackage rights have serious shortcomings. First, TFM has, to date, enforced strict limitations on the origins and destinations of the traffic FXE can handle using these rights. Second, FXE must pay onerous trackage rights fees to use the rights. FXE's trackage rights carry a rate of \$0.71 per car-mile, or more than double the rate BNSF pays to use its trackage rights over UP in the United States.¹⁸ Tex Mex pays UP similarly low fees –

¹⁶ TFM's system is also shown in more detail on the "NAFTA Railway" map submitted with the Application.

¹⁷ TFM's route from Laredo to Mexico City is 709 miles. FXE's route from Eagle Pass to Mexico City is 1,116 miles. *See* Map at Exhibit A.

¹⁸ BNSF pays UP the equivalent of \$0.27 per car-mile for the trackage rights it obtained in the *UP/SP* merger. In the *UP/SP* case, various parties challenged the trackage rights fees to be paid by BNSF as unduly high. *See UP/SP*, 1 S.T.B. at 413-17. FXE's rates are far higher, create a much greater cost disadvantage, and come close to consuming the entirety of the revenue available to FXE from rail movements using these rights.

only \$0.31 per car mile – for its trackage rights between Robstown and Beaumont it obtained in the UP/SP merger.¹⁹ Not surprisingly, FXE has used these trackage rights very sparingly.

Many points in Mexico that in theory could be served by both TFM and FXE are in reality not competitive, due to these inherent cost differentials. As shown in Exhibit H, the high trackage rights fees impose a serious cost disadvantage – on the order of 75 percent – relative to TFM for traffic moving between the United States and Mexico City and points south.²⁰ FXE can reduce this differential by using its own route, but at the cost of significant service penalties, and FXE's costs still are significantly higher – on the order of 57 percent – than TFM's.

Moreover, a significant portion of current international traffic through Laredo is moving to or from points in Mexico served solely by TFM. For example, TFM has the only access to eighty percent of the shippers in the industrialized region surrounding Monterrey, and it provides the only service to the industrial centers of San Luis Potosí and Toluca. Although FXE, in theory, obtained access to TFM-served shippers in Monterrey as part of the privatization process, to date, TFM has successfully blocked FXE from implementing that access. As Mr. Fuentes explains, Mexican legal and regulatory processes do not yet allow for prompt resolution of disputes involving railroads.²¹ TFM's legal challenges have forestalled

¹⁹ BNSF and Tex Mex rates are based on application of the gross-ton-mile rates they pay to a 30-ton railcar loaded with 100 tons of freight moved one mile (and averaged for the loaded and empty mile). Lighter weight intermodal and automotive movements incur even lower charges in the United States.

²⁰ The chart on the right side of Exhibit H compares FXE's costs with TFM's costs, using uniform assumptions about the two railroads' operating costs per mile.

²¹ For example, TFM was able to obtain a court order staying an August 2002 regulatory decision that would have given FXE access to shippers in Monterrey as anticipated by the Mexican privatization plan. Fuentes V.S. at 7.

FXE competition in the Monterrey area for several years, with no end in sight. In large part because of intractable regulatory processes, the Mexican privatization process has not yet secured the degree of competition originally envisioned.

c) TFM Has Cooperated Extensively With UP and Tex Mex to Develop Efficient Cross-Border Transportation Via Laredo

Finally, a key to the effectiveness of the Laredo Gateway stems from the extensive cooperative steps that TFM has undertaken with both of its connections at Laredo. Since privatization, TFM – controlled by its Mexican parent Grupo TMM – has cooperated extensively with both UP and Tex Mex to develop efficient cross-border rail transportation offerings. TFM has also worked with Tex Mex, KCS, and BNSF to ensure that Laredo is an efficient and cost-effective gateway for shipping goods to and from Mexico.

TFM's cooperation with UP has taken a myriad of forms that benefit shippers both north and south of the border. TFM has provided UP with reasonable rates and rate factors to enable effective competition between UP-TFM routes and those involving KCS-Tex Mex and BNSF-Tex Mex. In addition, TFM has worked with UP on a wide array of operational issues, including pre-blocking of rail cars, directional handling of empties, and cooperation at Laredo Bridge. The two railroads have coordinated on border crossing issues, such as data exchange for blocking and customs purposes. And TFM has helped UP support customer requirements through the supply of railcars and related services. The cooperation between the two railroads has extended into marketing, including TFM's provision of rapid and responsive rate quotes and UP's one-stop customer service offering known as "MexDirect." I discuss this cooperation in more detail below, at page 22.

TFM has cooperated with Tex Mex and its U.S. connections, KCS and BNSF, as well. KCS and TFM, for example, pre-block traffic for one another, which "relieves Tex

Mex of the cost and responsibility for switching cars and trains, and allows more rapid movement of freight to and from Mexico.”²² Moreover, TFM has taken many of the same cooperative steps for BNSF traffic moving via Tex Mex. Taken together, these steps have made Laredo into an efficient and low-cost rail gateway for U.S.-Mexico trade.

C. Unconditioned KCS Control of Tex Mex and TFM Will Harm Competition

Many railroad consolidations have created improved transportation options for rail shippers and had generally pro-competitive effects. UP has extensive experience with such consolidations, having implemented the UP/MP/WP merger, the UP/MKT merger, the UP/CNW merger and most recently the UP/SP merger. All of those transactions, as conditioned by the Board, allowed the merged company to offer new, more efficient single-line services in competition with single-line routes of its rivals.

If the proposed transaction enables KCS/Tex Mex/TFM to offer improved single-system services, it too may have procompetitive effects. However, there are important differences between this transaction and other end-to-end transactions of the past. Those differences create unusually high risks that, unless subject to effective conditions, the transaction will cause significant harm to competition for traffic moving via the Laredo gateway. The unusual threats posed by this transaction stem from the following factors:

- The transaction would give a single U.S. carrier control over the only Mexican railroad serving the vital Laredo Gateway as well as the vital Laredo Bridge. Until now, U.S. carriers have competed vigorously with one another north of the border, relying on TFM (and TFM’s subsidiary, Tex Mex) to cooperate with each of them in a neutral and

²² Application (KCS-3/TM-3), Riney V.S. at 136.

efficient manner. Mexican law has required that TFM cooperate neutrally with both Tex Mex and UP, and with TFM under Grupo TMM control that requirement has coincided with TFM's self-interest.

- Shifting control over TFM from its Mexico parent (Grupo TMM) to a U.S. carrier (KCS) will extinguish TFM's cooperation with UP in situations where UP-TFM services compete with KCS/Tex Mex services. KCS will gain effective control over competition between UP and KCS/Tex Mex in the United States. Shippers have in the past indicated strong preferences for UP-TFM routes via Laredo. KCS will be able to disrupt UP-TFM services by using its control over TFM and Tex Mex, and many shippers relying upon UP-TFM services will face higher costs and poorer service from KCS's unconditioned control of Tex Mex and TFM.

- It appears unlikely that the transaction will produce significant pro-competitive benefits to offset anticipated effects. KCS/Tex Mex/TFM already regard their "NAFTA Alliance" as providing seamless service and do not anticipate any changes in operations as a result of KCS control. Any gains to KCS will stem not from meaningful steps to improve TFM/Tex Mex/KCS offerings, but from anticompetitive efforts to make UP-TFM services less attractive to customers.

1. TFM Has Acted Neutrally Under TMM Control, Allowing for Effective Competition by U.S. Carriers North of the Border

Since privatization in 1996, TFM has been controlled by Grupo TMM, a large Mexican conglomerate. The U.S. carriers that participate with TFM in international rail movements – UP, KCS (via Tex Mex) and BNSF (also via Tex Mex and to a limited extent via the Brownsville gateway) – have competed against one another north of the border, while

relying on TFM's neutral cooperation with respect to the Mexican portion of international movements.

a) **TFM has Cooperated Extensively with UP to Develop Efficient and Attractive UP-TFM Rail Transportation Offerings**

TFM's neutral role as the sole Mexican carrier serving the vital Laredo Gateway is reflected in the extensive cooperation between UP and TFM to improve UP-TFM services. Just as TFM and Tex Mex (with KCS) have cooperated to expand Tex Mex's international traffic, TFM and UP have built an effective partnership that has brought important benefits to U.S.-Mexico rail shippers for movements via Laredo. That cooperation has covered the full array of activities associated with developing and improving effective and competitively-priced interline rail services options via the Laredo Gateway. TFM has cooperated by providing UP with reasonable rates and rate factors, cooperating on service design and improvements, streamlining border crossing processes, ensuring prompt car supply for UP's Mexican customers, and numerous other steps. I describe the UP-TFM cooperation in these areas in more detail in Appendix A.²³

2. **KCS Control of both Tex Mex and TFM Will Create New Incentives to Tilt the Competitive Playing Field**

The many cooperative measures described above and in Appendix A have allowed the continued improvement of UP-TFM transportation options. These improvements largely explain why UP-TFM traffic via Laredo has almost doubled since 1995. At the same

²³ UP and TFM hold frequent meetings on a multitude of issues related to cooperation at Laredo. At the assistant vice president level, the railroads convene process improvement meetings every other month. The railroads also hold quarterly executive sessions at the vice president level. Through such management coordination, UP and TFM have been able to provide customers with better U.S.-Mexico rail service.

time, consistent with the Board's intent in imposing conditions on the UP/SP merger, two-railroad competition north of Laredo has become stronger. TFM has worked cooperatively with Tex Mex and its connections (KCS and BNSF) to improve these carriers' US-Mexico interline services as well. Tex Mex's cross-border traffic (with both BNSF and KCS) has grown by { } percent since 1995. Shippers in the United States and Canada that wish to route U.S.-Mexico traffic through Laredo already have several strong competitive options.

Once it gains control of both Tex Mex and TFM, however, KCS will have new incentives and new abilities to limit shippers' choices by making UP-TFM options less attractive to customers, unless the Board imposes appropriate conditions to implement Applicants' generalized commitments not to undertake such strategies. By themselves, the commitments do not offer sufficient protection. It is essential that the Board impose conditions that make these commitments more definite and enforceable – which can be done without sacrificing any potential efficiencies flowing from KCS control. Otherwise, the interests of shippers and the competitive process will suffer.

KCS's incentives to use its control of Tex Mex and TFM to disrupt the competitive process are obvious. For many U.S.-Mexico rail movements, UP routes compete directly with KCS-Tex Mex-TFM and BNSF-Tex Mex-TFM routes. By increasing the costs of UP-TFM options or making them less attractive from a service perspective (and by discouraging TFM cooperation with UP in pursuing service improvements), KCS will be able to enhance its profits in ways that are detrimental to shippers. In shifting traffic to KCS and Tex Mex, allowing the NAFTA Rail system to earn additional profits north of the border, KCS will (1) deprive shippers of efficient UP-TFM services they enjoy today, and (2) allow

KCS-Tex Mex-TFM to increase rail rates to reflect the cost penalties it has managed to impose on UP.

Although UP today handles the majority of traffic moving via the Laredo Gateway, most of that traffic can be handled via KCS and Tex Mex. KCS/Tex Mex can compete head-to-head with UP-TFM routings for traffic moving to Canada, the Eastern United States, and the U.S. Midwest. KCS has connections with the eastern and Canadian railroads at most of the important mid-continent gateways. It also has its own routes to Kansas City, Chicago and St. Louis and other important traffic points.²⁴ Moreover, KCS has well-developed "alliance" relationships with many of its connecting carriers that allow it to take advantage of efficient run-through and coordinated train services and joint marketing of KCS-Tex Mex-TFM services.²⁵

For example, KCS's alliance with IC&E/DM&E gives it efficient access to Chicago, as well as extensive reach in the grain-gathering regions of Iowa and southern Minnesota. KCS also has very efficient connections with alliance partner Norfolk Southern at Meridian, Mississippi, for traffic moving between Mexico and the East, and with alliance partner CN at Jackson, Mississippi, for traffic moving between Mexico and the upper Midwest and Canada, as well as the U.S. east and Midwest via the Chicago and Memphis gateways. I describe KCS's access to the eastern gateways in more detail in Appendix B.

²⁴ Among the important traffic points served by KCS's system are chemical plants in Baton Rouge, Lake Charles and elsewhere along the Gulf Coast, forest products shippers on KCS's former-Midsouth lines in Mississippi, industrial shippers in the Kansas City area, and grain origination points in Iowa and Nebraska reached via KCS's haulage rights north of Kansas City.

²⁵ See generally KCS's own map of its network of routes and alliance partners. This map shows how KCS serves the major gateways (Exhibit I hereto). The NAFTA Railway map submitted with the Application also depicts most of KCS's alliance routes.

In addition, in conjunction with BNSF and TFM, Tex Mex can participate in traffic moving between Mexico and many of the points served by UP's network in the West. As shown in Exhibit J, more than { } percent of the rail traffic moving via Laredo is subject to competitive movement via KCS/Tex Mex and its connections in the United States, including BNSF.

Shippers have benefited from head-to-head competition between UP and KCS/Tex Mex for participation in U.S.-Mexico traffic via Laredo. In many instances, UP has won the business, reflecting shippers' preferences for highly efficient UP-TFM service offerings. For example, {

} Sometimes KCS/Tex Mex prevails, where these carriers can present rate and service offerings more attractive than UP's offerings. For example, {

} UP competed for this business, but did not prevail. These examples demonstrate the extent to which competition for U.S.-Mexico rail traffic has flourished. In these situations and many others, competition among rail carriers north of the border – all able to compete on a level playing field, because of TFM's neutrality – has led to lower rates and improved service offerings. KCS's acquisition of control of TFM and Tex Mex – unless conditioned – will alter the competitive landscape and extinguish these benefits for many shippers.

3. KCS Will Be Able to Use Its Control of Tex Mex and TFM to Make UP-TFM Options Less Attractive to Customers

The viability of two-railroad competition at Laredo depends on TFM cooperation with both of the U.S. carriers serving that vital gateway. Under Grupo TMM control, TFM's cooperation with both UP and Tex Mex has flourished, because TFM has treated its two connections at Laredo neutrally. After KCS takes control of both Tex Mex and TFM, however, this situation will change. KCS will have powerful incentives to use its control of TFM to render UP-TFM options that compete with KCS/Tex Mex routes less attractive to shippers by raising the costs of those options or unwinding cooperative steps that have led to service improvements.

a) Anticompetitive Rate-Based Strategies

TFM's rates (or rate factors) are perhaps the single most important aspect of TFM cooperation for U.S.-Mexico traffic. UP could have routes north of the border that were clearly the most efficient, UP could have completely unconstrained services to the Laredo Bridge, and shippers could prefer UP services hands-down over those offered by KCS-Tex Mex and BNSF-Tex Mex. However, if the rates TFM charges shippers for UP-TFM movements were too high, shippers would lose the benefits of UP competition.

For the past six years, TFM has fostered effective competition among U.S. carriers by quoting comparable rates and rate factors to both UP and Tex Mex for Laredo traffic. As I explained above, TFM has done this in part because its parent, Grupo TMM, has no economic interest in favoring KCS routes over UP routes, and in part because of Mexican non-discrimination requirements.

When it acquires control of TFM, KCS will have the power to manipulate TFM's rates (or rate factors) to make competing UP-TFM services more expensive for

shippers causing them to pay more, and in some cases forcing them to switch to less desirable KCS/Tex Mex offerings. KCS could accomplish this without causing TFM to refuse outright to quote TFM rates to UP, and even without causing TFM to discriminate between UP and KCS/Tex Mex in the rates it does quote. All KCS would need to do is cause TFM to raise its rates, which Mexican law would allow.

A simple numerical example (spelled out in Table 1 below) helps illustrate how such a strategy might work. (The numbers are purely illustrative.) Assume that before KCS gains control of Tex Mex and TFM, TFM has provided both UP and KCS/Tex Mex a rate factor of \$100 for traffic to an eastern gateway, and that UP and KCS/Tex Mex compete to handle the traffic north of Laredo. Assume that UP has the more efficient route and charges a rate factor of \$100. KCS's rate factor is \$105. In a fair competitive process, UP will win the business, and the shipper will pay a total of \$200. This outcome is shown in the left-hand portion of the bottom row of Table 1.

After KCS acquires control of Tex Mex and TFM, it can change this result to the disadvantage of shippers. All it needs to do is instruct TFM to raise its rate factor by at least six dollars, as shown in Example 1 in the table. If it did that, the combination UP-TFM rate would now be \$206, while KCS TFM could charge \$205 and win the business. KCS would develop the \$205 rate by lowering its own factor to \$99, a step it could take because it can now get those dollars back through its ownership of TFM. The combined KCS/Tex Mex/TFM would make more money (and more profit, assuming KCS's previous \$100 factor included some return), but the shipper would pay more and lose its preferred route north of the border.

TABLE 1			
	BEFORE KCS-TFM CONTROL	AFTER KCS-TFM CONTROL	
		Example 1	Example 2
UP Factor	\$100	\$100	\$100
KCS Factor	\$105	\$99	\$95
TFM Factor	\$100	\$106	\$120
UP-TFM Rate	\$200	\$206	\$220
KCS-TFM Rate	\$205	\$205	\$215
Outcome	UP wins; shipper pays \$200	KCS wins; shipper pays \$205	KCS wins; shipper pays \$215

KCS could use a similar strategy to increase its profits to shippers' detriment where service rather than rates had led shippers to prefer UP-TFM routings prior to KCS's acquisition of control of Tex Mex and TFM. In the above example, assume that UP and KCS/Tex Mex had offered to handle traffic from Laredo to an eastern gateway at comparable \$100 rate levels, taking advantage of TFM's non-discriminatory (\$100) rate factor, but that the shipper had chosen the UP route because, for example, it offered consistently faster transit times. After the transaction, TFM could increase its rate factor by \$5 to both UP and KCS/Tex Mex, with KCS/Tex Mex lowering its factor by \$5 to offset TFM's increase. To avoid a rate increase (from \$200 to \$205) the shipper would be forced to use KCS/Tex Mex's route north of Laredo, which it did not prefer. Alternatively, the shipper may conclude that it has a sufficiently strong preference for UP service that it is willing to pay \$5 more to use it (a fact TFM likely would not have known until KCS/TFM attempted this strategy). Either way, KCS/Tex Mex/TFM would earn additional profits and the shipper would lose.

It is my understanding that KCS would have a great deal of latitude to increase TFM's rates even further than suggested by these examples, thereby making it even more

difficult for UP-TFM service offerings to remain price-competitive. Mr. Fuentes explains that there are no effective Mexican regulatory limits on the level of TFM's rates for transportation within Mexico. Within the experience of UP's Mexico Group, statutory rates published by the Mexican government (the so-called "TUCE" rates) are so high as to be unusable. Thus, KCS apparently could cause TFM to increase its rate factors as much as necessary to assure that UP was effectively disabled from competing. KCS would reduce its portion of the through rate enough to win the business and increase its profits, but not so much that the traffic would dry up. The right-hand portion of Table 1 (labeled Example 2) demonstrates the effect of a \$20 increase in TFM's factor, which would allow KCS/TFM to win the business while simultaneously increasing the customer's rates significantly.

KCS's implementation of such a strategy would hurt shippers and competition, not just UP. For a number of reasons, TFM does not extract the last dollar of revenue that might conceivably be available by virtue of TFM's market power from each piece of traffic moving via Laredo. Most rates are quoted to customers on a "Rule 11" basis, which involves each railroad charging the customer its own, separate rate to the U.S./Mexico border, typically without any agreement by the carriers about what the overall origin-to-destination price should be. This limits the degree to which TFM can differentiate among customers based on their specific circumstances and demand factors. For many shippers, moreover, TFM quotes one rate to the Mexican receiver (or shipper), while the U.S. carrier quotes its rate to a separate entity (either the shipper or receiver) in the U.S. TFM's practice of quoting non-discriminatory rates also limits the extent to which it can effectively charge the highest rate that each piece of traffic can bear. In UP's experience, TFM's rates generally do not exploit the full measure of TFM's potential market power today.

North of the border, for traffic that is competitive between UP and KCS/Tex Mex (and its connections), competition among the U.S. railroads keeps rates competitive today – preventing either U.S. carrier from picking up the dollars TFM leaves on the table. Because of this competition, moreover, UP would not have significant room to reduce its own revenue requirement in order to offset higher TFM factors that KCS could impose. As a result, when KCS's strategies extinguish existing competition from UP north of the border, they will remove constraints on KCS's rates and cause rate increases (and reductions in the level of rail service) available to shippers.

KCS likely would conclude that this strategy would not work the same way or to the same extent for all shippers. For those shippers with better access to other transportation options (such as truck or barge) or that otherwise have more elastic demand, KCS could offer lower rates by reducing its factor north of the border by a greater amount. For traffic that UP could efficiently route via Eagle Pass in conjunction with Ferromex, KCS might choose to maintain the status quo, so that TFM could be certain of retaining the Mexican portion of the revenues. But for significant amounts of existing Laredo traffic (both UP-TFM and Tex Mex-TFM), a profit-maximizing KCS strategy would be to increase rates selectively and deteriorate UP-TFM services overall.

This strategy would be even easier for KCS/Tex Mex/TFM to implement if Mexican law did not limit TFM's ability to provide its U.S. connections different rate factors for comparable traffic. If TFM were permitted to discriminate against UP overtly, KCS could simply cause TFM to raise its revenue requirements to UP but not to KCS/Tex Mex, and the result would be the same: UP's costs effectively would go up, KCS could win the business despite charging higher rates, and shippers would lose.

KCS appears to believe that its acquisition of control of TFM would change the way Mexican law applies, and allow TFM to discriminate overtly in favor of KCS-Tex Mex-TFM routes once KCS acquired control of TFM. In a presentation delivered in Mexico a few weeks ago, KCS disagreed with suggestions that TFM would be required to “provide ‘equal’ rates to the Mexico/U.S. border” once KCS acquired it. KCS criticized any such requirement as precluding NAFTA Rail from offering, “in the form of lower prices to the Mexican shipping public, the benefits of the long haul on its system.”²⁶ UP has no desire to prevent KCS from offering *lower* rates to shippers to reflect any single-system benefits stemming from the proposed transaction. Based on Applicants' statements to the Board in this case, however, the transaction does not appear likely to achieve any such benefits, as discussed below (at pages 33-34). But if KCS is correct that TFM could discriminate by charging lower rates to favor long-haul KCS routings, it is necessarily also true that it could discriminate by charging *higher rates* to shift traffic away from efficient UP-TFM routings.

b) Anticompetitive Service-Based Strategies

Wholly apart from presenting the opportunity to increase UP-TFM rates by manipulating TFM's rate factors, KCS control of both Tex Mex and TFM provides opportunities for KCS to make UP-TFM transportation offerings less attractive (or more costly) in many other ways. As I explained above, the efficient UP-TFM services available to shippers today depend on many forms of cooperation by TFM. KCS – with very different incentives from today's TFM – could unwind many of those cooperative steps, or implement them with less vigor, in order to make UP-TFM options less attractive to shippers.

²⁶ KCS White Paper, p. 4 (Exhibit K hereto).

The measures available to KCS extend to most of the ways TFM cooperates with UP today. In the area of operations, TFM could discontinue pre-blocking cars south of the border or reduce the movement of empties through Brownsville/Matamoros. Eliminating pre-blocking would result in innumerable delays for UP shippers, causing those using private cars to incur additional car ownership costs and slower transit times. TFM could also give less priority to trains carrying UP traffic, or a lower priority to premium UP-TFM trains relative to KCS/Tex Mex/TFM trains. It could delay spotting empty equipment, setting out loads at customer sidings, or pulling loaded cars when the traffic is coming from or destined for UP at Laredo. Shippers would pay the ultimate price through delays and increased costs.

In addition, KCS could cause TFM to become less cooperative in pursuing commercial and marketing opportunities. For example, KCS could cause TFM to delay in providing revenue requirements to UP or rate quotes to customers using UP north of the border. TFM could also discontinue participation in cooperative arrangements, such as MexDirect, that provide customers with one-stop shopping for movements to and from Mexico. With reduced TFM cooperation, shippers would receive less favorable commercial terms, effectively increasing their costs.

In the vital area of customs processes, which can account for significant delays at the border, TFM could reduce its cooperation with respect to automated customs pre-clearance processes for shipments that are moving to or from UP. Because effective implementation of pre-clearance processes requires proactive efforts by both connecting railroads, even subtle reductions in TFM's cooperation could have significant consequences for the efficiency of UP-TFM cross-border movements and the level of service shippers receive.

Any of these steps would degrade the competitive rail transportation options that shippers enjoy today, or preclude UP from continuing to improve its cross-border services in ways that would otherwise have occurred naturally over time absent KCS control of Tex Mex and TFM. KCS says that it will not take any of these steps, and that it will instead “continue to cooperate” with UP in all of these areas.²⁷ UP welcomes KCS’s commitment. As I discuss below (at pages 40-42 and 47-48), however, KCS’s commitment needs to be embodied in a concrete and enforceable condition imposed by the Board in this case.

4. There Are No Meaningful Efficiencies Flowing from the Transaction to Offset the Threat of Anticompetitive Effects

Applicants have indicated in their Application and Supplement that the KCS/Tex Mex/TFM transaction will not result in any significant efficiencies that might offset the potential anticompetitive effects I describe above. To the extent the transaction leads to diversions of traffic to Tex Mex and KCS routes, those diversions will not be the product of procompetitive improvements due to increased efficiency from single-system routes. As the Applicants have repeatedly acknowledged, KCS and its “NAFTA Railway Alliance” partners already cooperate very closely today. As of a year ago, the NAFTA Railway Alliance had “developed a seamless, one-stop customer service approach for moving traffic in and out of Mexico on the NAFTA Railway.”²⁸ Similarly, KCS and Tex Mex had put into effect “the

²⁷ See Supplement to Application (KCS-10/TM-10) at 25; Letter from William A. Mullins to David L. Meyer, July 21, 2003 (filed with Board and served on all parties of record) (“Applicants’ July 21 Letter”), p. 1 (included as an Exhibit to UP’s Comments); KCS White Paper (Exhibit K), p. 2.

²⁸ KCS NEWS, “*NAFTA Railway Partners Reflect and Pursue New Opportunities*,” July 9, 2002 (available on www.kcsi.com) (Exhibit L hereto).

consolidation of KCS and Tex Mex dispatching, crew calling and timekeeping to KCS's System Transportation Center in Shreveport."²⁹

The operational efficiencies Applicants acknowledge having already achieved are similar to those UP and TFM have achieved, without common control. KCS does not plan any further integration of TFM beyond what has already occurred: the Application states that "the TFM transaction will not alter the basic structure or operations of TFM."³⁰ Thus, unlike mergers that promise to reduce administrative expenses or allow for service improvements, KCS control of TFM will not produce any direct synergies.

Nor is it plausible that, in the absence of cost savings or efficiencies arising from the transaction, KCS's control will lead it to lower KCS-Tex Mex-TFM rates to attract traffic. If it wished, it could take this step today. KCS's efforts to "lengthen hauls" by shifting UP-TFM traffic to Tex Mex-TFM and KCS-Tex Mex-TFM routes must inevitably focus on measures that harm shippers and competition. As I described above, this would include efforts to raise the costs of UP-TFM movements or make UP-TFM movements less attractive to shippers by manipulating TFM's rate factor upward or by discontinuing (or freezing in place) TFM cooperative efforts that have helped to produce efficient UP-TFM service offerings.

²⁹ *Id.* UP's Comments provide further details on the existing degree of integration among the NAFTA Railway Alliance partners.

³⁰ Supplement at 25.

5. The Availability of UP-FXE Routes Via Eagle Pass or Other Transportation Options Would Not Allow Shippers to Avoid the Transaction's Anticompetitive Effects

Applicants have suggested that KCS could not or would not cause TFM to manipulate the competitive landscape in the manner I describe above because some shippers have other transportation options. Applicants argue that many rail shippers have truck and water transportation options, and that UP could divert traffic from the Laredo Gateway to Ferromex routes via Eagle Pass. These options, Applicants suggest, will deter KCS/TFM from closing the Laredo Gateway or otherwise acting anticompetitively. In addition, Applicants suggest that TFM's dependence on traffic that it currently interchanges with UP for a significant portion of its revenues will deter TFM from taking actions to shift this traffic to Tex Mex and KCS routes. I disagree.

To be sure, there are competitive options for some of the traffic that UP interchanges with TFM at Laredo. Some could be moved by truck, or moved to the border by rail and transloaded into trucks for final delivery. Some could be moved by water to or from the Mexican Gulf ports. And some could be moved by rail via the Eagle Pass gateway. For most shippers, however, these options will not avoid the potential anticompetitive effects of the transaction, for at least three reasons.

First, most shippers using rail transportation via Laredo today do not have equally attractive non-rail options. For them, shifts to alternative modes of transportation would impose additional costs or other disadvantages. As discussed above, rail transportation has distinct advantages over truck or barge movements for important traffic flows at Laredo because of geography (*i.e.*, distance of the shipper from ports and cargo transfer costs at ports, both in the United States and Mexico), cost advantages of rail relative to trucks, and other factors. Competition between railroads in the United States ensures that the cost and other

advantages of rail are passed on to shippers. If that competition were disabled, many shippers likely would sustain increased rates or reduced service levels before choosing an inferior option provided by another mode.

Notwithstanding Applicants' broad assertion that TFM faces substantial intramodal and intermodal competition, there are significant U.S.-Mexico traffic flows for which TFM provides a significant advantage in terms of price and service over the next best alternative. Applicants (and USDA) discuss options available to grain shippers, but their discussion focuses on movements in the aggregate rather than considering the options available for particular origin-to-destination markets. In fact, trucks are used only to transport relatively small quantities of grain produced in the area between Corpus Christi and San Antonio, Texas. Water transport handles larger volumes in the aggregate, but it is an effective option only for locations in the United States efficiently served by the Mississippi River system and then only for shipments destined to points in Mexico that are effectively served by Veracruz and other Mexican ports. For grain moving from most of the U.S. Midwest to large portions of eastern and central Mexico, rail is the only viable option, and for much of that traffic, including large receivers in San Luis Potosí and Querétaro, the only rail service available is provided by TFM.

Applicants also tell only half the story with respect to automobile parts and finished automobiles. For shippers and receivers of relatively small quantities of auto parts – typically parts moving to a third-party supplier in Mexico – truck is often a more attractive option than rail. However, for large volume shipments moving directly between parts manufacturers or consolidation centers in the East and Upper Midwest and automobile manufacturers in Mexico, the economics of boxcar or intermodal service are vastly superior to

truck service. The difference involves a combination of volume and service – when a large receiver such as Chrysler or General Motors pays the freight, they are able to smooth the border clearance process and take advantage of the lower rates rail can offer. Moreover, for some receivers, such as Chrysler's plant in Toluca, TFM is not only the most efficient rail option, it is the only option.

With respect to finished automobiles moving from Mexico to the United States, truck is not a viable option. Water transport is an option for some automobiles manufactured in the Mexico City area, primarily for shipments to the East Coast. For finished automobiles moving from Mexican locations to U.S. points that are not on the coast, rail is the only option. And, as with auto parts, for certain manufacturers, TFM is the only rail option.

Applicants did not even attempt to discuss competition for other significant flows of U.S.-Mexico traffic that move by rail today. Producers of many other commodities also depend heavily on rail transportation to provide seamless, efficient transportation between the U.S., Canada and Mexico. Rail transportation offers many such commodity producers the ability to ship more volume at one time directly to a given location, and often for a lower rate than by truck. For example, shippers such as AK Steel move large volumes of steel (especially coiled steel for auto manufacturing) from U.S. origins to TFM-served industrial facilities in central Mexico. That traffic could not move efficiently via truck or water. Likewise, shippers such as Unimin and Badger Mining move large volumes of specialized minerals (like ball clay and industrial sand, respectively) from U.S. production facilities to TFM-served plants in Mexico. That traffic cannot move by water between inland points and it cannot move economically by truck to large, rail-served receivers.

Second, significant amounts of traffic moving via Laredo could not effectively be shifted to alternative rail routes via Eagle Pass. Laredo is the preeminent gateway for many reasons. *See* pages 10-20. Some traffic (including traffic of shippers served only by TFM) could not be moved via Eagle Pass because it is dependent on TFM's rail network within Mexico. For other traffic, UP-TFM routes via Laredo offer important cost and service advantages, as discussed above. The fact that UP-TFM traffic via Laredo has grown much faster than UP-FXE traffic via Eagle Pass – despite UP's equity interest in FXE – provides a telling indication of Laredo's advantages. *See* Exhibit F.

Equally important, Eagle Pass's existing infrastructure could not accommodate a significant shift of all potential traffic from Laredo. Massive and wasteful investments in new rail capacity and border crossing infrastructure would be needed at Eagle Pass before significant volumes of Laredo traffic could be switched to Eagle Pass. A diversion of traffic to Eagle Pass would also strand tens of millions of dollars of UP investments that have supported efficient UP-TFM cross-border commerce at Laredo.

Third, to the extent some shippers do have readily available and equally attractive transportation operations for their rail movements over the Laredo Gateway, those options would not protect other shippers. NAFTA Rail can identify traffic that could shift gateways or modes and focus their anticompetitive strategies on traffic with less attractive options. They would thereby retain TFM's current revenues on traffic that could shift, while increasing NAFTA Rail's profits on traffic more dependent on rail service over the Laredo Gateway.

In addition, it is highly unlikely that KCS would be deterred from applying these strategies to the UP-TFM traffic that cannot effectively be diverted to Eagle Pass out of

fear that UP might retaliate by diverting some *different* UP-TFM traffic away from TFM. KCS no doubt already expects that – as a result of KCS acquiring control of TFM – UP will attempt to shift traffic to Eagle Pass where possible in order to remove it from potential interference by KCS. Thus KCS would not expect its implementation of anticompetitive strategies to lead to any additional, incremental diversions beyond what UP would be able to accomplish in any event. KCS therefore will not pass up opportunities to use control over TFM to shift profitable traffic to KCS and Tex Mex routes.

III. UP’S PROPOSED LAREDO GATEWAY AND SERVICE CONDITIONS ARE NARROWLY TAILORED TO REMEDY THE ADVERSE COMPETITIVE EFFECTS OF AN UNCONDITIONED TRANSACTION WITHOUT INTERFERING WITH APPLICANTS’ EFFORTS TO COMPETE USING NEW SINGLE-SYSTEM ROUTES

The Applicants recognize that there are legitimate concerns about the effect of KCS control of Tex Mex and TFM on competition for U.S.-Mexico traffic, but their proposed solution is insufficient to protect against the potential harms. In an effort to convince the Board and the shipping community that competitive harms will not materialize, Applicants have made three important commitments:

- KCS will use its control of TFM to keep the Laredo gateway open on “commercially reasonable terms”,³¹
- KCS will use its control over TFM to (a) ensure that UP and BNSF are provided the same level of service they have experienced in the past and to making improvements to that level of service where possible; (b) require TFM to cooperate with UP and BNSF on pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars for shipments, accommodating run-through train service, providing excellent

³¹ Applicants’ July 21 Letter, p. 2; Supplement at 4 & Davies V.S. at 15.

service, and promptly quoting rates; and (c) work with UP and BNSF to develop a methodology for measuring and enforcing service standards for traffic handled by TFM via the Laredo Gateway;³² and

- Applicants will (a) work cooperatively with UP toward efficient utilization of the Laredo Bridge and (b) negotiate in good faith with UP to develop new dispatching protocols for the Laredo Bridge.³³

Although Applicants have focused on the right issues, their commitments are too vague to be effective. UP urges the Board to condition its approval in this case on Applicants' adherence to their commitments *and* on Applicants' negotiating in good faith with UP to establish concrete and enforceable agreements to implement those commitments. The Board should establish as a basic guideline that the final agreements should allow Applicants to pursue whatever efficiencies they might accomplish as a result of their transaction, while preserving competition for traffic moving over the Laredo Gateway.

In the sections below, I describe UP's view of how best to implement Applicants' commitments to keep the Laredo Gateway open on commercially reasonable terms and to continue to work with UP on cross-border traffic. In a separate statement, Stephen R. Barkley, UP's Regional Vice President - Southern Region, addresses Applicants' pledge to treat UP fairly at the Laredo Bridge. We offer only the broad outlines of implementing arrangements, because we believe that it would be most desirable for the precise terms to be the product of negotiations between Applicants and UP under the Board's supervision.

³² Applicants' July 21 Letter, p. 2; Supplement at 4, 24-25 & Davies V.S. at 14-15.

³³ Applicants' July 21 Letter, pp. 1-2; Supplement at 4, 26-27 & Davies V.S. at 15-16.

A. The Laredo Gateway Condition

Acknowledging that NAFTA Rail will have incentives to preclude competition from competing interline routes via Laredo, Applicants have committed “to keep the Laredo gateway open on commercially reasonable terms.” Supp. at 24. The underlying competition-preserving principle is easy to articulate: for the Laredo Gateway to remain open on commercially reasonable terms, TFM must not effectively close off UP-TFM interline movements via the gateway by insisting on rates that are too high for UP-TFM routings to be competitively viable. This commitment is crucial. Even if UP received nondiscriminatory treatment at the Laredo Bridge and nondiscriminatory service for UP-TFM movements, those operating conditions would be irrelevant if UP could not attract any traffic because of high TFM rates for the TFM portion of the movement.

However, Applicants never explain what they consider to be “commercially reasonable terms.” Nor do they explain how those terms will be established and made available to shippers who use UP. In short, their commitment is in the right spirit, but it is too vague to ensure the preservation of commercially viable TFM-UP routings in the face of their own strong incentives to force shippers to use NAFTA Rail routings. KCS recognized as much in a July 21, 2003 letter, in which it stated that it was “willing to enter into private discussions with UP or any other party to discuss this commitment and reach a private agreement to ensure that KCS abides by this commitment.”³⁴

The Board should hold Applicants to their basic commitment to keep the Laredo Gateway open. It should also hold them to their commitment to negotiate with UP to

³⁴ Applicants’ July 21 Letter, p.2.

establish a workable agreement to implement their commitment. However, the Board should not regard implementation as a purely private matter. It should be prepared to impose an appropriate solution if the parties fail to reach agreement.

UP believes there may be a variety of mechanisms that would offer a workable means of converting Applicants' vague commitment into an effective and enforceable remedy that preserves for shippers commercially-viable and competitive UP-TFM services, while at the same time allowing NAFTA Rail sufficient flexibility to adjust its rates to reflect merger efficiencies.

One effective approach might be a form of "proportional rate" agreement, perhaps modeled on an agreement reached between UP and BNSF in order to keep the Portland Gateway open on commercially reasonable terms following the UP/SP merger. In that case, the merging carriers and BNSF entered into an agreement that enhanced competition by transferring to BNSF a former-UP line in northern California, thereby creating a new BNSF single-line route between the Canadian border and the U.S. Southwest (the so-called "I-5 Corridor"). However, the railroads recognized that BNSF would no longer have incentives to work with UP on an interline basis via the Portland, Oregon gateway for traffic moving between BNSF-served points north of Portland (including points in Canada reached by BNSF indirectly) and points in UP's territory south of Portland. BNSF and SP had previously cooperated closely on such movements. In order to preserve the UP-BNSF interline option as a competitive alternative to BNSF's new single-line routes, UP and BNSF negotiated a mechanism – the I-5 Proportional Rate Agreement ("I-5 Agreement"). The I-5

Agreement allows UP to quote competitive rates for the full origin-to-destination movement of such traffic without the need for BNSF concurrence.³⁵

The I-5 Agreement has been quite successful. UP has been able to compete for traffic originating and terminating at the BNSF-served points subject to the Agreement, providing those shippers with a valuable competitive option. At the same time BNSF has been able to grow its own traffic volumes using its new single-line route. The I-5 Agreement and associated line sale have not frozen the pre-existing situation, but have created a dynamic, competitive environment that has benefited shippers using both UP and BNSF options.

The I-5 Agreement is not a rate equalization agreement. It provides a methodology for developing "BNSF rate factors" for the portion of the movement north of Portland, and UP pays BNSF a division based on those factors. BNSF cannot manipulate those factors to disable UP competition, but at the same time BNSF is free to charge shippers using its single-line route whatever it wishes. UP never learns what BNSF's competitive single-line rates are. In Appendix C I have summarized the basic principles underlying the I-5 Agreement, as they might be adapted to fit the situation presented in this case, where it is vital to keep the Laredo Gateway open for commercially reasonable UP-TFM offerings. Such an arrangement could effectively permit UP to provide shippers with competitive UP-TFM services via Laredo, just as the I-5 Agreement allows UP to offer competitive UP-BNSF services via the Portland gateway notwithstanding BNSF's incentives to inhibit competition with its single-line services.

³⁵ A copy of the I-5 Agreement as filed with the Board in 1997 (excluding the highly confidential rate matrix appendices) is Exhibit M.

UP is not asking the Board to require Applicants to agree to a condition based on the I-5 Agreement or even the basic attributes described in Appendix C. UP recognizes that the parties, through private negotiations, may be able to develop a more appropriate means of protecting competition for traffic moving over the Laredo Gateway. UP offers the example of its I-5 Agreement both as starting points for negotiations and to demonstrate that an effective, pro-competitive agreement is possible.

UP is well aware of concerns that gateway preservation conditions not resurrect the rate equalization requirements of the long-discredited *DT&I* conditions. Those requirements inhibited competition by discouraging consolidating carriers from reducing rates on new single-line routes to capture traffic. Consolidating carriers could not reduce their own rates without negotiating with connecting carriers to ensure that equal rates would be offered over all competing routes. They also had little incentive to attract traffic by reducing rates because they had to make those rates available to competitors before locking up the business. Competitors could thus free-ride on the consolidating carrier's marketing and cost-reduction efforts and "cherry-pick" the attractive business. In fact, consolidating carriers were forced to keep their rates high enough to cover the costs of a less efficient joint-line movement in the event that shippers chose a joint-line routing.

The gateway agreement that UP envisions would not undermine Applicants' incentives to pursue whatever pro-competitive benefits might arise from KCS control of Tex Mex and TFM. An agreement modeled on the I-5 Agreement that reflects the essential attributes in Appendix C would contain four specific features designed to preserve Applicants' pro-competitive incentives:

First, Applicants would be free to change their rates as market conditions allowed. *DT&I* conditions imposed a tremendous burden on any effort to reduce rates because consolidating carriers were required to negotiate with their connections to ensure that equal rates would be offered over all competing routes. Under an arrangement similar to the I-5 Agreement, Applicants would be free to reduce (or increase) their rates for any traffic at any time, without engaging in a separate round of negotiations with UP.

Second, Applicants would not be required to inform UP every time they quote a shipper a new rate for handling competitive business. Unlike *DT&I* conditions, which allowed competing carriers to “cherry pick” attractive business, UP’s proposal would not require Applicants to provide lower, equalized rates in advance of moving traffic. UP would be entitled only to the TFM rate factors contained in the rate matrix. It would not be entitled to learn what rates Applicants intend to quote or have quoted a particular shipper. The Applicants could thus target business without revealing their activities to UP, and they could reduce their rates in order to attract that business without making those same reduced rates immediately available to UP.

Third, Applicants would always be able to offer shippers a lower TFM rate factor than the matrix factor available to UP, if they continue to reduce costs. Unlike *DT&I* conditions, which required immediate rate equalization, an arrangement like the I-5 Agreement contemplates only periodic adjustments to the rate matrix. In other words, UP would not be entitled to use a TFM rate factor based on NAFTA Rail’s most recent, lowest rates. The TFM rate factor available to UP would always lag behind the rates that NAFTA Rail was offering. The Applicants would thus have strong incentives to improve their efficiency and reduce costs, because such actions would allow them to remain ahead of UP in

their ability to reduce rates and capture traffic moving over the Laredo Gateway.³⁶ Moreover, Applicants' cost advantage over UP would last far longer than one quarter. As described above, TFM rate factors would reflect aggregated and averaged net revenues and divisions received by NAFTA Rail for *all* comparable traffic moving in the previous quarter, not just new movements. In other words, if Applicants reduced their rates to capture one shipper's business during a particular quarter, but they also moved other traffic under older, higher rates, then the next quarter's rate factor would reflect a blended rate, not just the most recent, lower rate.³⁷ Applicants would thus have strong incentives to pursue whatever legitimate efficiencies they might accomplish as a result of their transaction.

Fourth, Applicants would have the "first look" at all new business that would create a new matrix cell. Under the I-5 Agreement, if a shipper asks UP to move business with a STCC/car type combination for which there is no pre-existing BNSF rate factor, UP must ask BNSF for a rate factor as if there were no agreement in place. If this practice were applied here, it would preserve NAFTA Rail's incentives to develop new business opportunities that might arise as a result of their transaction.

These four features address valid criticisms of *DT&I* rate equalization conditions that have been offered in past cases. In particular, they address criticisms that *DT&I* conditions reduce pro-competitive incentives because they require consolidating carriers to share efficiencies related to their elimination of interchanges at gateways and thus

³⁶ Of course, UP would remain free to reduce its portion of a joint rate in order to respond to competition for traffic over the Laredo Gateway, just as if there were no Gateway Condition.

³⁷ The Gateway Condition thus not only allows Applicants to take advantage of any ability to reduce costs, but it also allows them to "cherry pick" certain business without making available the same low rates to UP.

subsidize less efficient connecting carriers. However, even without these features, those concerns would be far less significant in this case, because Applicants do not plan to achieve any efficiencies relating to the operation of the Laredo Gateway. *See* pages 33-34 above. Thus, a gateway condition would not undermine Applicants' incentives to reduce their own rates; it would work only to ensure that they do not unfairly discriminate by raising rates for shippers that use UP.

Moreover, as discussed above, UP and TFM have developed their own highly efficient interline services via the Laredo Gateway. NAFTA Rail carriers are unlikely to develop a more efficient interchange than the UP-TFM interchange, particularly if TFM remains an independent company, and particularly if it continues to cooperate with UP. Thus, this is not a case in which a gateway condition would unfairly subsidize a non-applicant by requiring the sharing of merger benefits. The condition would simply guarantee that the existing, highly efficient UP-TFM interchange at the Laredo Gateway would remain open on commercially reasonable terms.

B. The Service Condition

Just as Applicants have incentives to preclude competition by manipulating TFM rate factors, they have incentives to preclude competition by manipulating TFM service provided as part of interline movements with non-NAFTA Rail carriers. In recognition of these anticompetitive incentives, Applicants have committed to "continue to cooperate with UP" regarding "pre-blocking rail cars, automated customers pre-clearance procedures, supplying cars, accommodating run-through train service, and promptly providing rate

quotes.”³⁸ In its letter of July 21, 2003, KCS also committed “to seeing that UP and BNSF are provided the same level of service they have experienced in the past, and to making improvements on that level of service where possible.”³⁹ It further committed to use its control of TFM “to require TFM to cooperate with both UP and BNSF on pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars for shipments, accommodating run-through train service, providing excellent service, and promptly quoting rates.”⁴⁰ Finally it stated that it was willing “to work with UP and BNSF on development of a methodology for measuring service standards and to develop a method by which such standards could be enforced.”⁴¹

On this issue, UP believes that Applicants’ commitments offer an effective solution – especially their commitment to “work with UP and BNSF to develop a methodology for measuring and enforcing service standards for traffic handled by TFM via the Laredo Gateway” – provided they are required to adhere to those commitments as a condition to Board approval. Moreover, as with the Gateway Condition, when the Board requires Applicants to live up to their commitment to negotiate with UP, it should not leave the process solely in private hands. The Board should condition its approval on a requirement that Applicants negotiate in good faith with UP to develop an agreement establishing methods for measuring compliance with their commitments regarding TFM service and mechanisms

³⁸ Supplement at 25.

³⁹ Applicants’ July 21 Letter, p.2.

⁴⁰ *Id.*

⁴¹ *Id.*

for enforcing compliance with those commitments, and it should be prepared to impose an appropriate solution should the parties fail to reach agreement.

Experience implementing the conditions imposed in the UP/SP merger demonstrates that there would be effective ways to implement mechanisms for measuring and enforcing Applicants' adherence to the Service Condition. In connection with the UP/SP merger, UP and BNSF jointly developed measures for monitoring train performance to ensure non-discriminatory treatment of trackage rights trains moving over each other's lines. The implementation of similar service measurements to monitor the treatment of UP-TFM traffic as compared to traffic moving via TFM-Tex Mex routings would go a long way toward fulfilling Applicants' commitment. UP believes that it would be important for the parties to develop additional measures that address other important aspects of TFM cooperation issues – including, for example, measures to compare train schedules, car supply, switching frequency, and customer service responsiveness – but UP's past positive experience demonstrates that good faith negotiations can produce an appropriate solution.

As I discussed above, active cooperation between UP and TFM has been indispensable in developing efficient U.S.-Mexico rail service. History has shown that active coordination of services and operations, including customs clearance processes, blocking, and run-through service, as well as the level of service TFM provides within Mexico on UP-TFM interline business, is essential to attracting and retaining U.S.-Mexico traffic. If the current level of coordination and cooperation between UP and TFM decreased as a result of the transaction, or if TFM discriminated against UP in working to improve existing services, customers would quickly switch to alternative services provided by Tex Mex and KCS, even if they were more costly or less efficient. The Applicants have repeatedly asserted that they

have every incentive to continue cooperating with UP. UP seeks nothing more than an enforceable condition requiring Applicants to back those assertions with action.

APPENDIX A

EXISTING UP-TFM COOPERATION

Reasonable Rate Factors

- TFM has consistently quoted UP reasonable and non-discriminatory rates and rate factors to facilitate effective competition between UP-TFM routes and routes involving KCS-Tex Mex and BNSF-Tex Mex. For the most part, railroad rates break at Laredo, with the carrier(s) north of the border collecting its freight charges with TFM charging and collecting its own rate. To our knowledge, TFM has provided the same rates to both of its connecting carriers at Laredo, in accord with principles of neutrality established under Mexican law and the Concession that privatized TFM. *See Fuentes V.S.* at 4-5.

Marketing and Service Design

- An important feature for growing any transportation market is the ability to respond quickly and effectively to customer requests for pricing. Railroads must be able to quickly analyze the market environment and develop prices which help our customers participate in the ever changing opportunities they encounter. TFM has always proven to be an effective and aggressive market partner that has quickly responded to these opportunities with prices that are competitive. Similarly, TFM has also been a good partner in developing the service packages needed to attract and retain business.
- TFM and UP have implemented a “one-stop” shipping system called MexDirect that helps to expedite the movement of products across the Mexican border. The railroads offer customers “quick quote” rates between UP-served

origins and destinations in the United States and TFM-served origins and destinations in Mexico. Other important MexDirect features include a single-point-of-contact serving both sides of the border; easily understood information on doing business in the two countries, such as instructions on how to obtain credit, place car orders, create bills of lading and trace cars; a single bill, in U.S. dollars; and multiple warehouse and trans-load options. These services could not be offered without proactive TFM cooperation. This recent program offers our customers dramatic simplification for cross-border commerce.

- TFM and UP hold semi-annual marketing meetings. At these gatherings, executives from both railroads explain the successes resulting from UP-TFM cooperation and discuss on-going interline opportunities. The respective marketing departments can then make actual and potential customers aware of the benefits resulting from UP-TFM cooperation.

Operational Coordinations

- UP and TFM have cooperated to develop efficient pre-blocking for traffic moving via Laredo. Pre-blocking involves the delivery by a connecting railroad of blocks of cars all of which are moving to some intermediate point on the receiving railroad's system. Pre-blocking is an important way for interchange partners to reduce each other's costs and improve service levels, since pre-blocked cars do not need to be reclassified at the border and then reclassified again closer to destination.

- At its San Antonio Yard, UP blocks manifest traffic and intermodal “Z” trains for TFM destinations deep within Mexico, such as Mexico City. In return, TFM prepares northbound “Z” trains, which do not require reclassification on UP’s system from the time they leave the Mexico City area until reaching Chicago. TFM also pre-blocks general merchandise trains for UP. For example, TFM prepares blocks for UP’s Alton & Southern Yard at East St. Louis and for the Livonia Yard near Baton Rouge.
- Accommodating run-through train service. Run through trains are an important method of improving service to customers by avoiding the disruptions that can be caused by the process of interchanging freight cars between connecting railroads. It is particularly useful in an international situation, such as Laredo, where clearance procedures can further disrupt the free flow of goods. Expedited services are particularly dependent on run through trains if they are to be effective.⁴²
- Directional handling of empties. TFM and UP also have implemented a cooperative policy regarding empty cars. The two railroads have agreed to route many empties through Brownsville/Matamoros to the extent possible (although many still go through Laredo). This routing of empties helps to keep the key gateway of Laredo less congested, thereby maximizing the ability of

⁴² An important part of run-through service is the air testing and inspections that both parties perform before handing off trains to one another. UP tests and inspects cars headed for Mexico, and TFM does the same for UP on northbound cars. Although the FRA has not yet fully accepted the results of the TFM testing on northbound trains, UP nevertheless saves an hour on re-testing north of the border due to the assistance TFM provides. UP and TFM are working closely together to achieve FRA recognition of Mexican testing.

Laredo to move loaded railcars. In order to keep the Laredo Gateway fluid, it is important that this practice continue.

- Cooperation at the Laredo Bridge. At the key crossing of Laredo, TFM has worked closely with UP and Tex Mex to improve the management of the Laredo Bridge, allowing the railroads to increase daily throughput over the Bridge dramatically.

Border Crossing Coordinations

- In addition to the investment in infrastructure at and near Laredo, UP and TFM have engaged in important cooperative efforts aimed at smoothing the border crossing process. The railroads must cooperate extensively in order to facilitate obtaining customs and other pre-clearances while customers are en route to the border to avoid the need for customers to spend days waiting at the border to cross. The same degree of cooperation is needed to coordinate efficient operations. For example, local operations managers from both railroads talk twice daily to prioritize operational issues and to handle any anomalies. UP and TFM also exchange data that identifies the blocks that need to be made.

Car Supply and Related Services

- For northbound shipments, TFM is responsible for arranging to supply empty rail cars for loading by customers. This is critical to efficient satisfaction of customer demand. Also of importance has been TFM's ability to efficiently manage empty cars that have moved loaded onto their railroad southbound.

Their ability to match these cars with the requirements of customers shipping northbound is an important factor in keeping costs under control and permitting both railroads to participate in markets that would otherwise have been unavailable. This is supported by TFM's additional services, including prompt switching of loaded and empty cars from customer sidings and empty car cleaning when necessary.

APPENDIX B

KCS ACCESS TO MAJOR EASTERN GATEWAYS

CHICAGO

KCS trackage does not reach Chicago, but it has several ways of reaching the gateway:

- KCS's primary access to the Chicago gateway is via its Alliance partner CN, via a connection at Jackson, MS. As part of the CN-KCS Alliance, this routing also provides KCS with access to traffic to/from CN-served points in Iowa, Wisconsin, Michigan and Canada.
- KCS also reaches Chicago via Kansas City under a Marketing Agreement with the Iowa, Chicago & Eastern ("IC&E"), which operates between Kansas City and Chicago.
- KCS has haulage rights over UP between Springfield, Illinois (which KCS reaches via Kansas City) and Chicago. This agreement dates to 1989, when SP acquired its St. Louis-Springfield-Chicago line.

ST. LOUIS

KCS serves the St. Louis gateway via Kansas City. (Its route includes the Kansas City-St. Louis line of the former Gateway Western Railroad, which is now an integrated part of KCS.) At East St. Louis, KCS connects with CN, CSX and NS for traffic to/from the East and Southeast.

KANSAS CITY

KCS serves Kansas City directly. At Kansas City, KCS connects with its alliance partner IC&E/DM&E, which provides a direct route to Chicago and also serves grain origin points in Iowa and Minnesota. KCS also connects with NS for traffic to/from other points in the Midwest and East.

MEMPHIS

KCS does not serve Memphis, but can access the major southeastern carriers (CSX and NS) at other gateways, as noted. KCS's primary route for traffic to/from points in the Memphis area is via the CN connection at Jackson, Mississippi.

NEW ORLEANS

KCS serves New Orleans, where it connects with CN, CSX and NS for traffic to and from the east. KCS's primary interchange at New Orleans is with CSX, because most traffic to/from CN and NS is interchanged elsewhere, as noted below.

JACKSON, MS

KCS serves Jackson, Mississippi, which is the primary KCS-CN gateway for traffic to/from much of the CN system, including Canada. The two carriers operate coordinated train service via this gateway.

MERIDIAN, MS

KCS serves Meridian, Mississippi, which is its primary junction with NS for traffic to/from the east. The two carriers operate run-through train service via this gateway.

BIRMINGHAM, AL

KCS serves Birmingham, Alabama, where it can interchange with CSX.

APPENDIX C

ONE EFFECTIVE APPROACH FOR KEEPING THE LAREDO GATEWAY OPEN ON COMMERCIALY REASONABLE TERMS

Purpose

- The agreement should ensure that UP (and carriers participating with it in joint-line routings) can offer shippers rates that include a commercially reasonable TFM factor for traffic moving via the Laredo Gateway between points in Mexico and points in the United States and Canada.

Scope

- The agreement should provide TFM rate factors that UP and other participating carriers could use for traffic moving between:
 - (a) any point in Mexico served by TFM (directly or through interchange with carriers other than FXE), and
 - (b) points in the United States and Canada served by UP or through UP via its connections.
- The agreement should cover all commodities (carload, bulk and intermodal).
- The agreement should cover both southbound and northbound movements.
- The agreement should cover shipments moved in railcars owned by railroads and third parties.

TFM Rate Factors

- The agreement should provide a matrix of TFM rate factors, in the form of net ton-mile rates (net of refunds, allowances, rebates, ancillary charges, and transload charges) for different commodities and car types.
- The net ton-mile rates in each cell of the matrix would be applied to the TFM mileage and the associated net tons between points in Mexico and the Laredo Gateway to develop the TFM factor.
- The agreement may provide for separate TFM rate factors applicable to different geographical regions within Mexico or the United States/Canada.

Development of TFM Rate Factors

- The initial rate factors should be determined based on the TFM portion of rates used in conjunction with UP-TFM interline movements (net of refunds, allowances, rebates, ancillary charges, and transload charges) in effect and actually moving business as of some reasonable benchmark prior to the announcement of KCS's acquisition of control of TFM and Tex Mex. A third party, such as a major accounting firm or other established transportation consultant (the "consultant") should be employed to compute rates for the TFM portion of UP-TFM movements.
- The net ton mile rate for each commodity/car type should be a weighted average of the rates applicable to movements of each such commodity/car type between the covered points.
- New rates should be derived each subsequent quarter based on KCS/Tex Mex-TFM and other Tex Mex/TFM rates or TFM rate factors actually moving business during the quarter. For Rule 11 rates, KCS/Tex Mex rate factors and route miles would need to be included for the portion of the movement north of Laredo.
- Once a cell in the matrix was filled, the rate factor should not be removed from the matrix if no traffic moved in a given quarter. Instead, the rate in the matrix should be adjusted to reflect rate changes for comparable traffic.
- The agreement should establish procedures to ensure that in settling interline accounts UP's and KCS/Tex Mex's revenues north of the Laredo Gateway are not disclosed to one other.

Service

- The agreement should provide for KCS to use its control of TFM to require that TFM provide service (including car supply, switching, pre-blocking and other handling) for movements as to which the agreement establishes TFM rate factors as TFM must provide in accordance with the other conditions imposed in this case.

Third Party Consultant

- The third party consultant should be jointly employed by UP and KCS/Tex Mex/TFM. The parties should share equally in the expense of employing the consultant. The parties should have the right to audit the consultant's work. The consultant should be required to remain impartial between UP and KCS/Tex Mex/TFM.

VERIFICATION

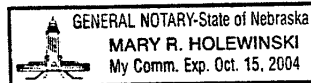
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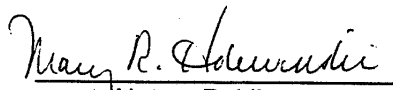
JOHN T. GRAY, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof and that the same are true as stated.



JOHN T. GRAY

Sworn to and subscribed before
me this 4th day of August, 2003.



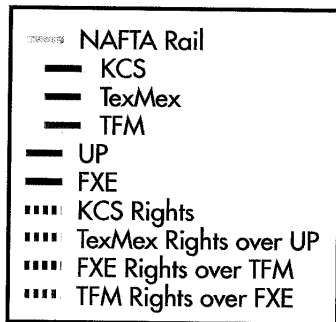


Notary Public

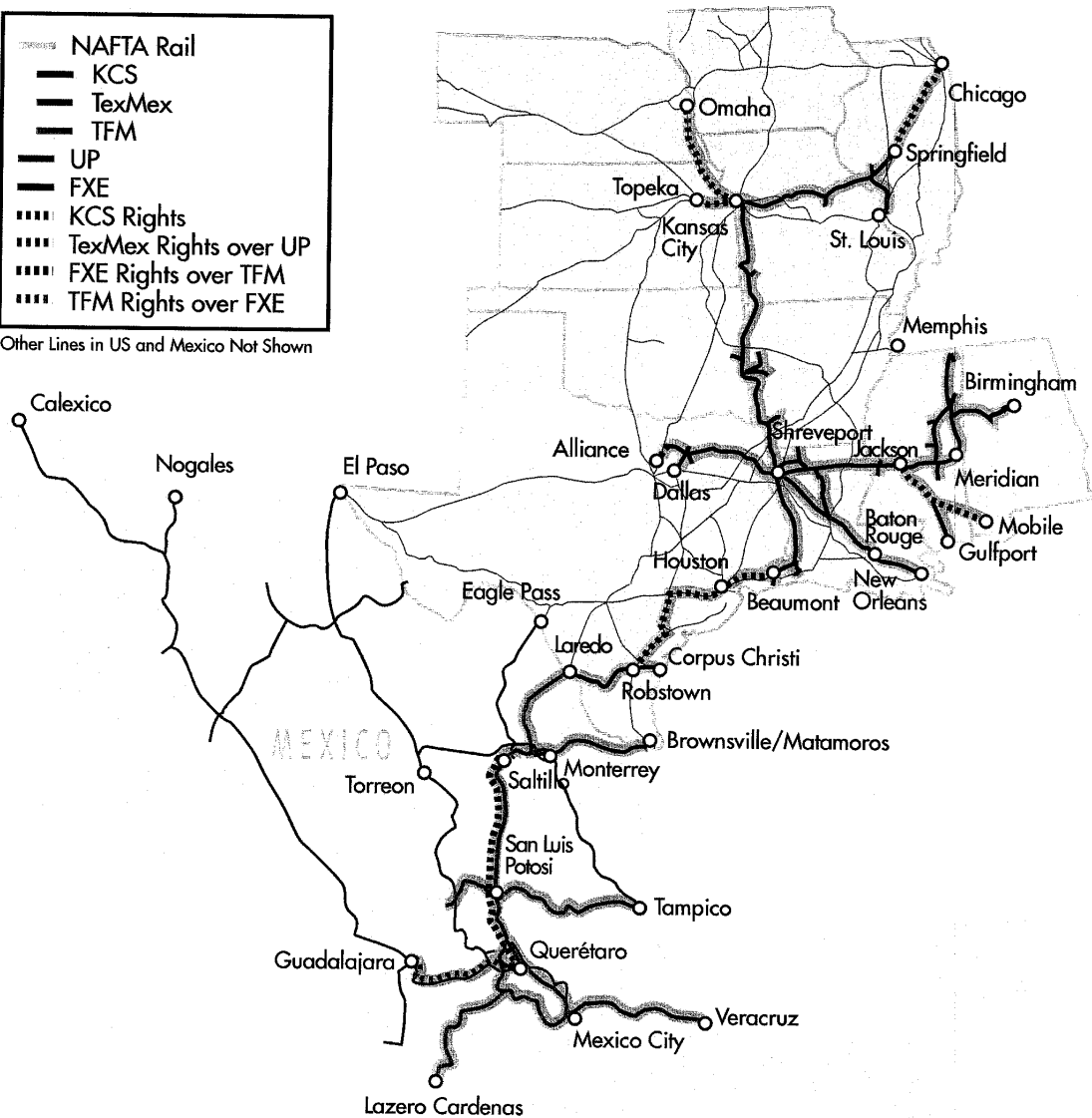
My Commission expires October 15, 2004

A

KCS - TexMex - TFM



Other Lines in US and Mexico Not Shown



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Year	U.S. Imports from Mexico by Rail	U.S. Exports to Mexico by Rail	Total US-Mexico Trade by Rail
1993 (Apr-Dec)	\$6,222,798,108	\$2,103,568,900	\$8,326,367,008
1994	\$7,769,002,773	\$4,192,037,736	\$11,961,040,509
1995	\$9,137,946,078	\$4,694,439,969	\$13,832,386,047
1996	\$12,297,683,361	\$5,119,248,882	\$16,992,123,330
1997	\$12,646,931,446	\$5,648,002,070	\$18,294,933,516
1998	\$12,029,664,622	\$6,188,777,197	\$18,218,441,819
1999	\$14,693,445,318	\$5,710,614,158	\$20,404,059,476
2000	\$21,056,113,884	\$10,495,792,020	\$31,551,905,904
2001	\$22,056,776,869	\$10,389,405,439	\$32,446,182,308
2002	\$20,790,689,267	\$10,143,004,235	\$30,933,693,502

Note that data between 1993-1996 include transshipment activity (i.e., shipments which entered or exited the United States by way of a US Customs port on the northern or southern borders but whose origin or final destination was other than Canada or Mexico). Data beginning with January 1997 **do not** include transshipment activity. Users should note these differences before comparing figures for 1993-1996 with 1997 and subsequent year data. Also note that the category "OTHER" was further subdivided into "OTHER" and Foreign Trade Zones (FTZ) beginning with the April 1995 data month.

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

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As filed with the staff of the Securities and Exchange Commission on April 23, 2003

Registration Statement No. 333-99075

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Post-Effective Amendment No. 2
to
Form F-4
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

GRUPO TMM, S.A.

(Exact name of registrant as specified in its charter)

TMM Group

(Translation of Registrant's name into English)

United Mexican States

(State or other jurisdiction of incorporation or organization)

6770

(Primary Standard Industrial Classification Code Number)

Not applicable

(I.R.S. Employer Identification Number)

Avenida de la Cúspide, No. 4755

Colonia Parques del Pedregal,

14010 Mexico, D.F.

(Address of principal executive offices)

CT Corporation System

111 Eighth Avenue

New York, NY 10011

(212) 894-8700

(Name, address, including zip code, and telephone number, including area code, of agent for service)

TMM HOLDINGS, S.A. DE C.V.

(Exact name of registrant as specified in its charter)

TMM Holdings

(Translation of Registrant's name into English)

United Mexican States

(State or other jurisdiction of incorporation or organization)

6770

(Primary Standard Industrial Classification Code Number)

Not applicable

(I.R.S. Employer Identification Number)

Avenida de la Cúspide, No. 4755

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14010 Mexico, D.F.

(Address of principal executive offices)

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(213) 892-4473

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New York, New York 10006
(212) 225-2632

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement and all other conditions to the exchange offers and consent solicitations described in the accompanying prospectus have been satisfied or waived.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. //

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. //

Our railroad operations consist of TFM and the Tex-Mex Railway.

TFM Railroad

TFM, through 2,641 miles (4,251 km) of main track and 637 miles (1,025 km) of trackage rights, operates the primary corridor of the Mexican railroad system which allows us to participate in the growing freight traffic moving between Mexico, the United States and Canada. TFM's rail lines connect the most populated and industrialized regions of Mexico with the principal border gateway between the United States and Mexico at Laredo-Nuevo Laredo. In addition, TFM's rail system serves three of Mexico's four primary seaports at Veracruz and Tampico on the Gulf of Mexico and Lázaro Cárdenas on the Pacific Ocean. TFM serves 15 Mexican states and the cities of Monterrey and Mexico City, representing approximately 70% of the country's population. TFM also expects to serve Guadalajara, Mexico's third largest city, through trackage rights with rail service to Laredo, Texas, the largest freight exchange point between the United States and Mexico, where TFM provides exclusive access from Mexico and also access from the United States through connections with the Tex-Mex Railway and the Union Pacific Railroad. We believe the Laredo gateway is the most important interchange point for freight between the United States and Mexico. Approximately 82% of TFM's total revenue in 2002 was attributable to international freight. The majority of this international freight was bound to or from the United States and Canada, crossing the U.S.-Mexico border at Nuevo Laredo, and most of the remainder came from overseas, principally through Mexico's seaports.

TFM's route structure enables it to benefit from the growing trade resulting from the increasing integration of the North American economies through NAFTA. Mexican foreign trade increased at an average annual rate of 18.8% from 1992 to 2000, increasing by 15.1% in 1999 from 1998 and by 22.5% in 2000 from 1999. Notwithstanding a decrease of 4.1% in Mexican foreign trade in 2001 from 2000 as a result of the slowdown of the U.S. and global economies, TFM's foreign trade increased 0.77% in 2002 from 2001.

TFM has significantly improved the operations of its rail lines by focusing on providing reliable and comprehensive customer service, implementing U.S. and Canadian railroad operating practices and making capital improvements to its track, systems and equipment designed to reduce costs and increase operating efficiencies. In 2002, TFM's operating ratio was 76.1% (78.5% including Mexrail), compared with an operating ratio of 93.6% for the first six months following commencement of its operations. TFM's operating ratio is better than the average operating ratio for the eight Class I railroads in the United States.* Operating ratio is an industry efficiency measure, which represents a railroad's operating expenses as a percentage of its transportation revenues.

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* Source: American Association of Railroads

The principal commodities hauled over TFM's rail lines are: industrial products, metals and minerals; agro-industrial products; automotive products; chemical and petrochemical products; and intermodal freight. TFM currently operates intermodal terminals located in Monterrey, Toluca and San Luis Potosí, and has access to intermodal terminals at Querétaro, Guadalajara, Ramos Arizpe and Encantada. In addition, TFM has direct access to Grupo TMM's intermodal facilities at the ports of Tampico, Veracruz and Lázaro Cárdenas and to intermodal terminals in Altamira and Manzanillo (through interline service with Ferromex) and in Mexico City (through the Mexico City Railroad Terminal). TFM also has access to intermodal terminals at Laredo operated by the Tex-Mex Railway and the Union Pacific Railroad, which it is using to develop international intermodal business.

TFM's rail lines serve major automobile and other manufacturing facilities at the intermodal terminals at Monterrey and Ramos Arizpe, important industrial and commercial districts, as well as at the facilities of many major customers.

Mexican Government Interests

In connection with the original formation of Grupo TFM, the Mexican government purchased a 24.6% non-voting interest in Grupo TFM for \$198.8 million. The Mexican government also granted the original shareholders of Grupo TFM an option (the "call option") to purchase the government's equity interest in Grupo TFM. On July 29, 2002, TFM purchased all of the call option shares for an aggregate purchase price of \$256.1 million. The purchase price for the call option shares was financed through (1) a portion of the proceeds of the issuance of \$180.0 million of debt securities by TFM and (2) \$85.2 million (based on the applicable exchange rate as of March 31, 2002) payable to TFM by the Mexican government as a result of TFM's recent transfer of a redundant portion of its track to the government, together with cash from TFM's operations. As a result of the acquisition of the call option shares, TFM expects to achieve financial benefits and reduce the Mexican government's involvement in its business. The Mexican government retains a 20% non-voting direct equity interest in TFM.

The Mexican government has the right to sell its 20.0% direct equity interest in TFM by October 31, 2003 in a public offering, subject to the approval of Grupo TMM and KCS. If a public offering of TFM shares does not occur by that date and the Mexican government exercises

its put option, Grupo TFM will have the obligation to purchase the Mexican government's interest in TFM at the original peso purchase price per share paid by Grupo TFM for its 80.0% equity interest in TFM, indexed to Mexican inflation. If Grupo TFM does not purchase the Mexican government's TFM shares, the Mexican government may require Grupo TMM and KCS, or either Grupo TMM or KCS alone, to purchase the TFM shares at such price and release Grupo TFM from its obligation. There is no assurance that Grupo TFM, Grupo TMM or KCS will have sufficient funds to acquire the Mexican government's interest. If the TFM Sale is completed, KCS will assume all of our obligations under the put option and will indemnify us from any losses incurred as a result of the exercise by the Mexican government of the repurchase right.

Following its privatization in 1997, TFM and its shareholders have negotiated with the Mexican government the resolution of certain matters related to the granting of the concession and its acquisition of related railroad assets.

In connection with these negotiations, on February 9, 2001, the Mexican government, through the Ministry of Transportation, issued an official statement pursuant to which TFM and the Mexican government agreed to the transfer by TFM of the redundant *La Griega-Mariscala* portion of its track back to the Mexican government. On February 12, 2001, the Mexican government amended TFM's concession title to reflect the reversion of the *La Griega-Mariscala* line to the Mexican government. The consideration for the transfer of the track was approximately Ps. 653.6 million, plus applicable value added tax, or approximately Ps. 751.6 million (approximately \$81.9 million as of December 31, 2001). The Mexican government paid the consideration for the *La Griega-Mariscala* line to TFM, amounting to \$85.2 million, in conjunction with the acquisition by TFM of the Mexican government's 24.6% interest in Grupo TFM on

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July 29, 2002. The *La Griega-Mariscala* track is a redundant 32-kilometer stretch of track which is part of TFM's dual track running between Mexico City and the city of Querétaro. The Mexican government subsequently granted the *La Griega-Mariscala* track to Ferromex to fulfill its obligation to provide Ferromex with a track along this route to facilitate transport by Ferromex through Querétaro.

At the same time, TFM's concession was also amended to relieve TFM from responsibility for the maintenance of the electrified catenary over the portion of its dual line between Huehuetoca and Querétaro and to authorize TFM's dismantling of the catenary over that portion of the line, which TFM completed in 1999. In addition, the amendment requires TFM to complete certain railway improvements which TFM believes will not involve material expenditures.

In addition to the foregoing, after a period of negotiation with Ferromex, TFM's principal Mexican rail competitor, and the Mexican government regarding the terms relating to the trackage rights required to be granted by TFM to Ferromex and by Ferromex to TFM under their respective concessions, TFM and Ferromex were unable to reach an agreement with respect to the fees to be paid by TFM and Ferromex for usage of the other's track. Therefore, in accordance with TFM's rights under the Mexican railroad services law, TFM asked the Ministry of Transportation to set these trackage rights using the applicable criteria under the Mexican railroad services law. In March 2002, the Ministry of Transportation issued its trackage rights ruling, which TFM is now appealing. See "Risk Factors—The rates for trackage rights set by the Ministry of Transportation may not adequately compensate TFM" and "—Legal Proceedings" for more information.

The Concession

TFM holds a 50-year concession title, renewable under certain conditions for an additional 50 years, to provide freight transportation services over its rail lines. This right is exclusive for the first 30 years of TFM's operations, subject to certain trackage rights to be granted to other Mexican rail operators. Under the concession, TFM has the right to use, during the full term of the concession, all rights of way, track, buildings and related maintenance facilities that are necessary for the operation of its rail lines. Under the terms of the concession, TFM is required to pay the government a fee equal to 0.5% of our gross revenues during the first 15 years of the concession period, and 1.25% of such revenues during the remainder of the period.

TFM is required to grant trackage rights along our rail lines to Ferromex, Ferrosur and the Mexico City Terminal Railroad. The Ministry of Transportation has the right to grant exclusive passenger service concessions utilizing TFM's rail lines to a concessionaire other than TFM. Under the concession and the Mexican railroad services law, TFM may freely set its rates unless the Mexican Antitrust Commission determines that there is no effective competition, taking into account alternative rail routes and modes of transportation. If the Mexican Antitrust Commission determines that there is a lack of competition in the railroad system, the Ministry of Transportation will establish the basis for TFM's rates. TFM's rates must be registered and applied in accordance with the Mexican railroad services law and regulations. In applying its rates, TFM must not make cross-subsidies, engage in tied sales or engage in other discriminatory pricing tactics. TFM is required to provide railroad services to all users on a fair and non-discriminatory basis and in accordance with the efficiency and safety standards approved periodically by the Ministry of Transportation. In the event that TFM collects from customers rates higher than the registered rates, it must reimburse those customers with interest.

The concession requires TFM to make investments and undertake capital projects in accordance with a business plan approved by the Mexican government. TFM is also responsible for compliance with efficiency and safety standards set forth in the concession, which are based

D

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Table 24

Top 10 U.S. Land Ports by Value of U.S.-NAFTA Surface Trade: 2000 and 2001

(Value in millions of current U.S. dollars)

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Rank in 2001	U.S. port	All surface modes			Truck			Rail		
		2000	2001	% Change	2000	2001	% Change	2000	2001	% Change
	U.S.-North American trade	575,713	547,312	-4.9	428,700	395,425	-7.8	94,198	92,617	-1.7
1	Detroit, MI	94,442	91,982	-2.6	85,468	79,762	-6.7	8,598	11,909	38.5
2	Laredo, TX	83,674	79,607	-4.9	60,047	55,298	-7.9	23,465	24,179	3.0
3	Buffalo-Niagara, NY	70,132	60,478	-13.9	54,659	47,196	-13.7	14,473	10,497	-27.5
4	Port Huron, MI	59,704	55,648	-6.8	32,770	29,955	-8.6	24,645	22,914	-7.0
5	El Paso, TX	39,376	37,931	-3.7	36,008	34,697	-3.6	1,433	1,575	9.9
6	Otay Mesa Station, CA	18,773	19,401	-3.3	18,760	19,385	3.3	0	0	NA
7	Champlain-Rouses Pt., NY	17,260	16,163	-6.4	15,326	14,271	-6.9	1,041	1,098	5.5
8	Nogales, AZ	13,631	12,509	-8.2	11,046	9,964	-9.8	2,576	2,543	-1.3
9	Hidalgo, TX	12,594	12,423	-1.4	12,444	12,211	-1.9	0	0	NA
10	Blaine, WA	12,303	11,687	-5.0	10,692	9,914	-7.3	1,536	1,724	12.3
	Top 10 as % of total	73.3	72.7		78.7	79.1		82.6	82.5	
	U.S.-Canada trade	365,118	346,515	-5.1	257,642	234,824	-8.9	62,646	60,171	-4.0
1	Detroit, MI	94,347	91,906	-2.6	85,375	79,687	-6.7	8,597	11,908	38.5
2	Buffalo-Niagara, NY	70,004	60,341	-13.8	54,531	47,059	-13.7	14,473	10,497	-27.5
3	Port Huron, MI	59,622	55,539	-6.8	32,689	29,846	-8.7	24,644	22,914	-7.0
4	Champlain-Rouses Pt.,	17,237	16,137	-6.4	15,303	14,246	-6.9	1,041	1,098	5.5

NY										
5	Blaine, WA	12,303	11,687	-5.0	10,692	9,914	-7.3	1,536	1,724	12.3
6	Alexandria Bay, NY	11,987	10,621	-11.4	11,981	10,615	-11.4	0	0	NA
7	Pembina, ND	10,577	8,886	-16.0	9,661	8,252	-14.6	180	107	-40.7
8	Sweetgrass, MT	7,773	8,269	6.4	6,446	6,888	6.9	470	564	19.9
9	Portal, ND	6,596	6,799	3.1	4,376	4,426	1.2	2,193	2,341	6.8
10	Eastport, ID	2,711	6,513	140.3	1,580	1,222	-22.6	907	819	-9.7
Top 10 as % of total		80.3	79.9		90.3	90.3		86.3	86.4	
U.S.-Mexico trade		210,595	200,797	-4.7	171,058	160,600	-6.1	31,552	32,446	2.8
1	Laredo, TX	83,674	79,607	-4.9	60,047	55,298	-7.9	23,465	24,179	3.0
2	El Paso, TX	39,376	37,931	-3.7	36,008	34,697	-3.6	1,433	1,575	9.9
3	Otay Mesa, CA	18,773	19,401	3.3	18,760	19,385	3.3	0	0	NA
4	Nogales, AZ	13,631	12,509	-8.2	11,046	9,964	-9.8	2,576	2,543	-1.3
5	Hidalgo, TX	12,594	12,423	-1.4	12,444	12,211	-1.9	0	0	211.2
6	Brownsville-Cameron, TX	12,108	10,911	-9.9	11,307	10,139	-10.3	746	735	-1.5
7	Calexico East, CA	8,320	7,348	-11.7	8,238	7,207	-12.5	81	140	72.4
8	Eagle Pass, TX	7,285	6,739	-7.5	4,135	3,599	-13.0	3,140	3,129	-0.3
9	Del Rio, TX	2,387	2,375	-0.5	2,387	2,375	-0.5	0	0	NA
10	San Luis, AZ	1,226	1,007	-17.8	1,226	994	-18.9	0	0	NA
Top 10 as % of total		94.7	94.7		96.8	97.1		99.7	99.6	

KEY: NA = not applicable

NOTE: Truck and rail will not sum to total land trade by port, because not all land modes are included here. Other land modes include pipeline, mail, unknown, and miscellaneous. Ports are ranked by totals for all surface modes.

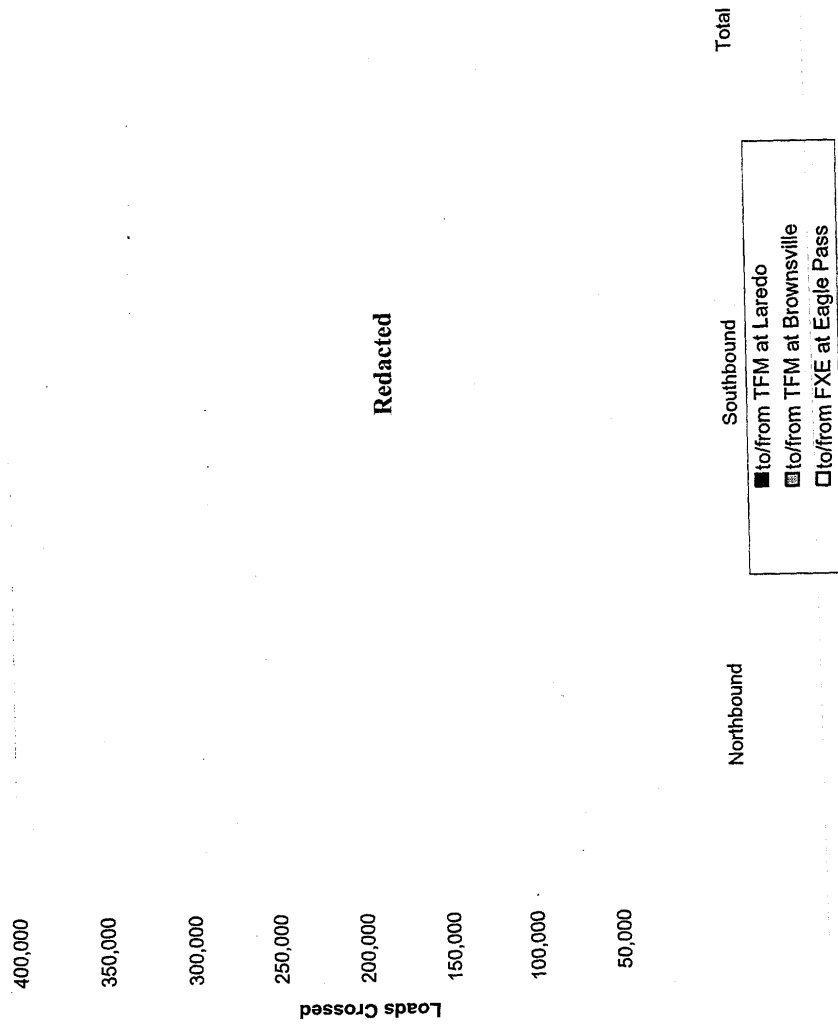
SOURCE: U.S. Department of Transportation, Bureau of Transportation Statistics, Transborder Surface Freight Data, as of January 2002.

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E

2002 U.S. Mexico Rail Traffic at Eastern Mexico Gateways
(All U.S. Carriers)



F

Laredo and Eagle Pass Rail Traffic
1995 to 2002

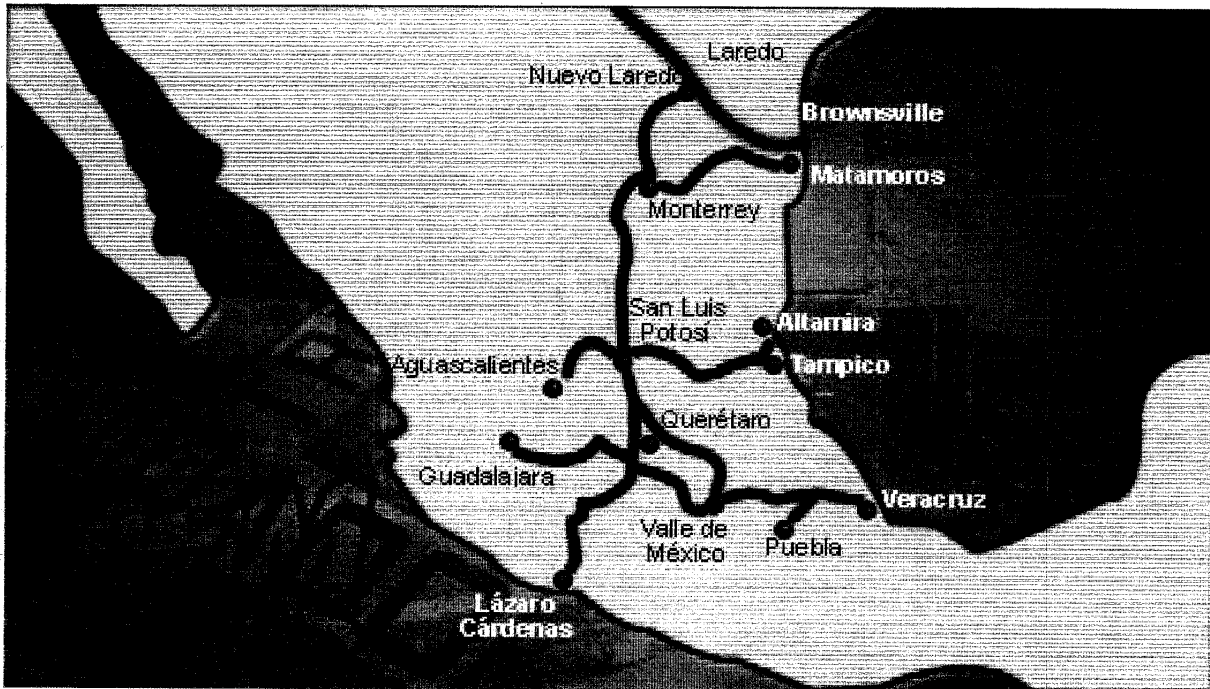


G

○ ROUTES

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Gray Exhibit G
Public



TFM serves Mexico's main industrial districts, including Mexico City, Queretaro, San Luis Potosi, Aguascalientes, Monterrey, Saltillo and Guadalajara, among others, and the ports of Veracruz, Lazaro Cardenas and Tampico/Altamira.

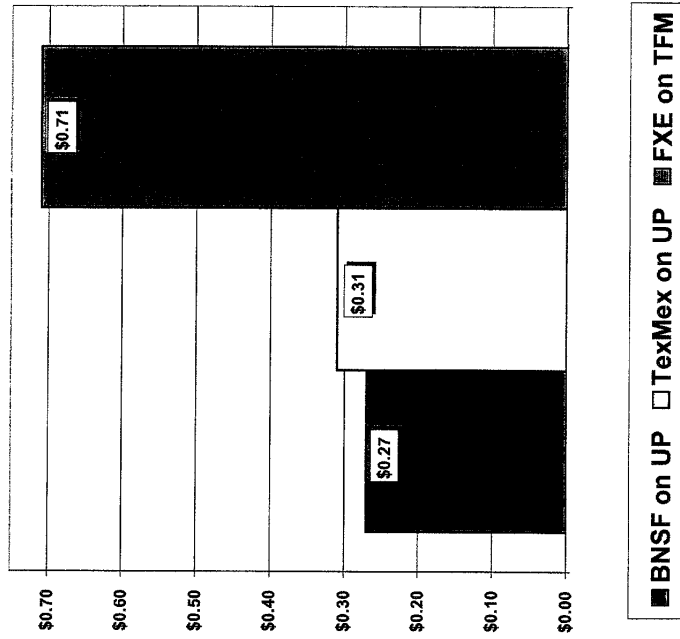
TFM provides the shortest route between major cities in Mexico and the U.S.A., and links up to the North American rail network at the border crossing points of Nuevo Laredo/Laredo and Matamoros/Brownsville, where more than 60% of commercial traffic between Mexico and the USA crosses the border.

[Map 1](#) | [Map 2](#) | [Map 3](#) | [Map 4](#) | [Map 5](#) | [Map 6](#) | [Map 7](#) | [Map 8](#) | [Map 9](#)

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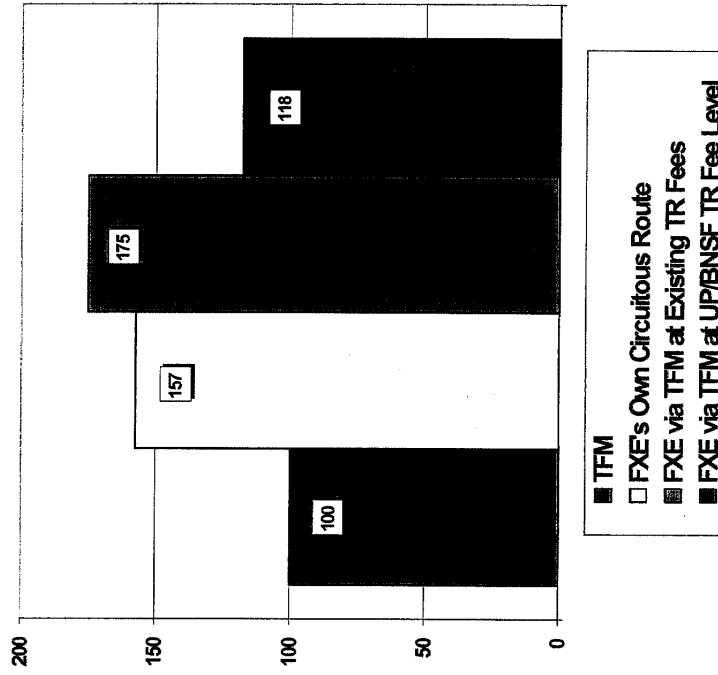
TFM Trackage Rights Fees Make FXE Non-Competitive

Trackage Rights Fees Per Car-Mile



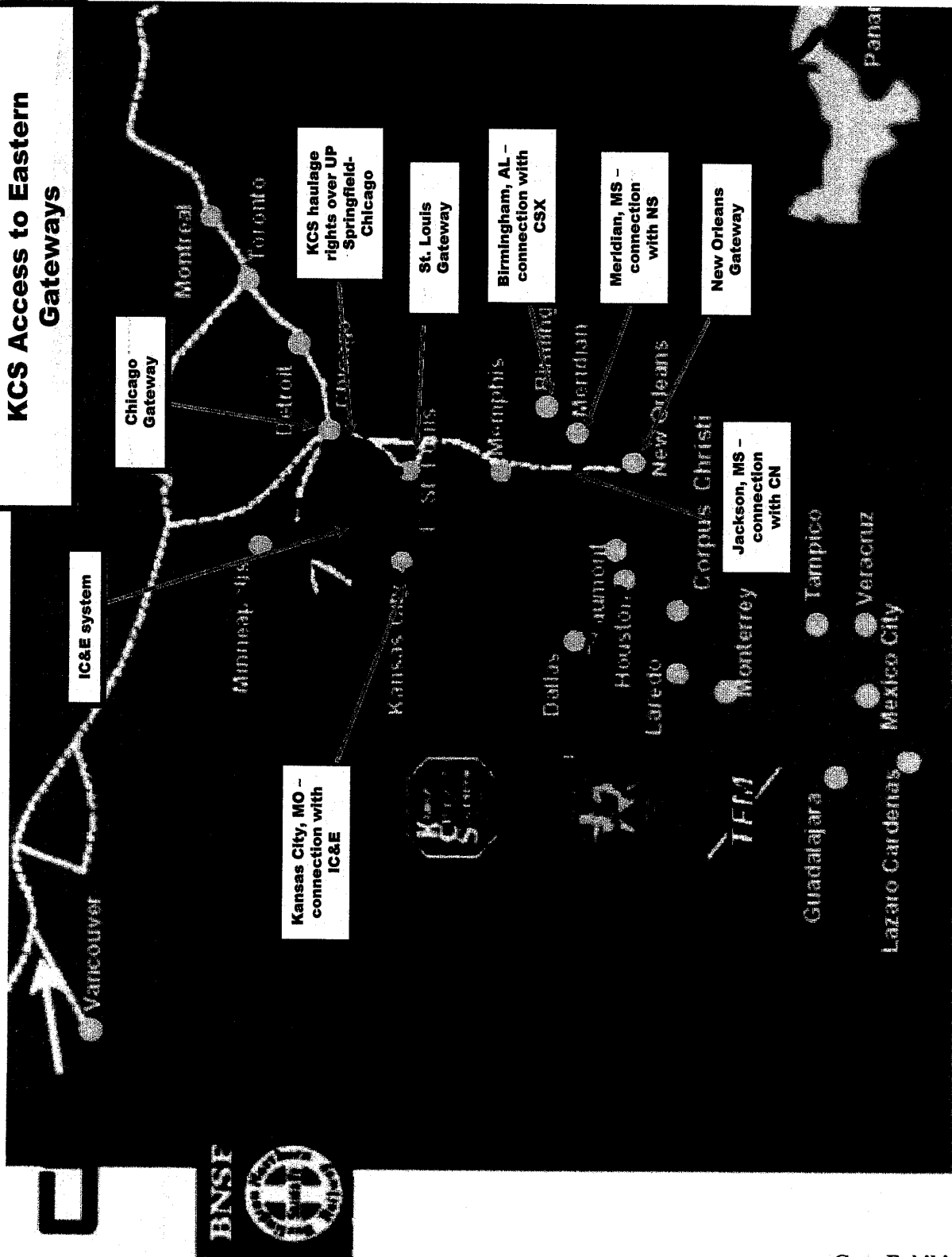
FXE's Trackage Rights Fees Are Very High

Indexed Route Variable Costs between U.S. Border and Mexico City



Those Fees Have A Major Impact on FXE's Costs

KCS Access to Eastern Gateways



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J

2002 Laredo Cross-Border Rail Traffic
(Traffic Subject to KCS/Tex Mex Competition)



Redacted

K

NAFTA Rail



NAFTA Rail Will Enhance Mexico/U.S. Rail Competition Providing Shippers A Strong Rail Alternative

The agreements announced between Grupo TMM and Kansas City Southern to create **NAFTA Rail** (a common-control holding company for TFM, The Kansas City Southern Railway, and the Texas Mexican Railway) will enhance Mexican/U.S. rail competition and provide shippers with a strong, new rail alternative in the NAFTA trade corridor.

This is the next step in the effort to develop an effective rail competitor in cross border traffic which was found to be in the public interest by the U.S. Surface Transportation Board in the Union Pacific/Southern Pacific merger in 1996. NAFTA Rail will be that competitor. It will provide seamless, efficient and competitive rail service to shippers in North America and strengthen the ability of the three carriers to invest in their infrastructure, equipment and technology, improving their ability to compete.

NAFTA Shippers Need An Effective Cross Border Rail Competitor; NAFTA Rail Will Be That Competitor

NAFTA Rail is focused on enhancing competition. Because of Union Pacific's dominance of the current Mexico/U.S. rail traffic, shippers need a second rail competitor in this market that is economically viable and able to provide a competitive alternative to UP's dominance. Shippers should have a choice. NAFTA Rail will give shippers a choice.

Today, Union Pacific is the dominant rail carrier between Mexico and the U.S.:

- UP carries 90% of the northbound traffic and 79% of the southbound traffic between Mexico and the U.S. via all six rail gateways;
- At the Laredo, Texas gateway, UP controls 91% of the market share for northbound traffic and 71% of the market share for southbound traffic;
- From Chicago to Laredo, UP controls 98% of the rail traffic;
- From St. Louis to Laredo, UP controls 98% of the rail traffic;
- From Houston to Laredo, UP controls 86% of the rail traffic; and,
- UP currently operates to and from Mexico through all six international gateways.

By comparison:

- At Laredo, BNSF/Tex-Mex has just 5% of the northbound traffic and just 12% of the southbound traffic;
- At Laredo, KCS/Tex-Mex has just 3% of the northbound traffic and just 12% of the southbound traffic;

- BNSF has one direct gateway to Mexico and reaches two more gateways via trackage rights over UP; and,
- KCS/Tex-Mex has only one gateway to Mexico at Laredo, and it depends on trackage rights over approximately 350 miles of UP in Texas to reach this gateway where it competes with UP for Mexican rail traffic.

In addition, Union Pacific has a 26% ownership in Mexico's largest railroad concession, Ferromex, which is TFM's competitor in Mexico. Clearly, Union Pacific dominates rail traffic to and from Mexico.

Trade between Mexico and the United States is the fastest growing trade relationship in the world. Economic growth in both countries relies on this trade and on competitive transportation alternatives to keep it flowing.

Protecting the domination of this vital rail market by one carrier as exists today is not in the shippers' interests nor is it in the public interest. Shippers need an effective cross border rail competitor to provide a viable alternative to the market dominant carrier.

It is in the public's interest to have such a competitor. NAFTA Rail will be that competitor by providing seamless, efficient and competitive rail service to shippers in North America while strengthening the ability of TFM, the Kansas City Southern, and Texas Mexican railroads to invest in their infrastructure, equipment and technology improving their ability to compete.

It's In NAFTA Rail's And Its Customers' Interests To Work With All Carriers In North America

While NAFTA Rail will provide shippers with a competitive alternative to UP in certain markets, NAFTA Rail will also need to cooperate with UP and BNSF in a substantial number of other markets. UP is an important interchange partner with TFM, generating important revenues for its future. UP and BNSF together control approximately 90% of the rail traffic in the United States west of the Mississippi River. Both serve vast territories that NAFTA Rail will not reach. As such, NAFTA Rail will and must continue to cooperate with both carriers on interline services, but also will be a vigorous competitor wherever it can provide alternative rail service to the customer. Working with other carriers is and will be a business necessity for TFM.

UP's chairman, Dick Davidson said recently about TFM, "...we became quite good business partners down there and I would anticipate that would continue." KCS agrees. Under NAFTA Rail, its carriers will continue to cooperate with UP, BNSF and other carriers on:

- Pre-blocking rail cars;
- Improving automated customs pre-clearance procedures;
- Supplying cars for shipments;
- Accommodating run-through train service;
- Providing excellent service: and,

- Promptly quoting rates.

Under NAFTA Rail, the Laredo gateway will be kept open to UP, and Tex-Mex will provide the same fair service to UP at the Laredo bridge as it has in the past. Tex-Mex will also work with BNSF to route traffic via Laredo, even though BNSF has other gateways to Mexico. It is in NAFTA Rail's and its customers' best interests to work with all carriers in North America.

Proposals to Limit Competitive Rail Pricing in Mexican Market Undermine Competitive Rail Service

Rail service pricing in the Mexican market has numerous similarities to the U.S. with the exception that effective competitive options in Mexico are even more available than in the U.S. Consequently, rail pricing in Mexico is very constrained by truck and water competition.

When the Mexican railroads were privatized in 1996-97, their estimated market share was less than 10%. This low market share was driven by the relatively short distance between Mexican freight markets which, in turn, facilitates vigorous truck competition. Easy access to deep water ports on both the Pacific and Gulf Coasts; difficult railroad operating conditions from both Mexican coasts to the interior; and a very inefficient railroad operation with low quality rail service, prior to privatization, also made truck competition successful over rail. As a result, the Mexican economy became and continues to be very dependent on trucks. These were some of the elements that led the Mexican Government to conclude that privatization of the rail system was the right course of action for Mexico.

Since privatization, there have been enormous changes in the rail system. The Mexican rail system was broken up to create three primary rail competitors: TFM, Ferromex, Ferrosur. Competition among the newly privatized rail lines and intensive port and truck competition have led the railroads to rapidly improve service, freight car availability, infrastructure, information systems and customer service. At TFM, for example, more than \$1 billion (U.S.) has been invested in freight cars, rail, ties, locomotives and information systems during the last 6 years. The result has been a success for the Mexican shippers and the Mexican public. The rail market share now is estimated to be in the 16% to 17% range. While this gain is significant, rail market share in Mexico is only about one-third of what it is in the U.S. As an indicator of the future growth potential of rail, the border crossing at Nuevo Laredo/Laredo reported the passage of more than one million trucks in 2002.

The current balance between the two largest rail franchises in Mexico – Ferromex and TFM – has produced good results for Mexico. Ferromex is the largest of the rail franchises in Mexico and covers more of the country than does TFM. Ferromex serves four of the six U.S. border crossings while TFM serves only two. Ferromex serves the majority of the grain destinations in Mexico but TFM serves more of the auto parts manufacturers and automobile plants.

Proposals being floated by Union Pacific (UP) would undermine rail competition in Mexico and lead to virtual control of the Mexican rail market by UP. To understand these proposals, it is helpful to remember that UP owns 26% of Ferromex and controls nearly 90% of all the rail traffic between Mexico and the U.S.

In an effort to maintain its control of Mexico-U.S. trade flows, UP has offered two dramatic proposals to protect it from competitive alternatives like NAFTA Rail:

- **Proposal I**

This proposal would give Ferromex additional mandatory trackage rights over TFM so that Ferromex could serve the Laredo gateway directly. Such a broadening of Ferromex was not contemplated by the government's privatization plan nor included in the rail franchises when they were offered for privatization. This expansion of Ferromex would upset the competitive balance achieved in the privatization process and have the effect of allowing Ferromex to serve five of the six routes between Mexico and the U.S. Because UP owns 26% of Ferromex, this would guarantee UP's continued dominance over Mexico-U.S. trade. The Mexican and the U.S. shipping public would, however, be precluded from ever benefiting from competitive rail service.

- **Proposal II**

This proposal is for TFM to provide "equal" rates to the Mexico/U.S. border. Such a proposal would deprive NAFTA Rail of the ability to offer, in the form of lower prices to the Mexican shipping public, the benefits of the long haul on its system from, for example, Mexico City to Meridian, Mississippi or Birmingham, Alabama. In addition, Ferromex is TFM's primary rail competitor. With UP controlling Ferromex's pricing (through its 26% ownership), with enforced "equal" rates as suggested by UP, UP could control the economic viability of both primary rail systems in Mexico and the prices paid by Mexican shippers. In short, "equal" rates give UP a way to control its 90% market share and deprive the Mexican and U.S. shipping public of the benefits of competitive rail service. Moreover, UP's proposal is contrary to Mexican law and regulations which grant each rail carrier in Mexico the right to freely set their own rates in the competitive marketplace.

NAFTA Rail is an effective way to bring a new rail service offering into the NAFTA trade corridor. NAFTA Rail will bring competitive discipline to the NAFTA trade corridor. And, NAFTA Rail will benefit both Mexican and U.S. shippers so NAFTA trade can reach its full potential.

NAFTA Rail Will Remain The Smallest Class I Rail Carrier

Despite strengthening its ability to compete, improving its ability to invest in infrastructure and being the effective rail competitor for cross border traffic that shippers need, NAFTA Rail still will be, by far, the smallest Class I rail carrier in the United States.

In 2002:

- UP had annual revenues of approximately \$12.5 billion (U.S.) making it the largest Class I rail carrier in the United States;
- KCS had revenue of under \$600 million (U.S.) making it the smallest Class I carrier in the United States;
- If the NAFTA Rail transaction is approved, its combined revenues will be about \$1.3 billion (U.S.), just over 10% of UP's 2002 revenues;
- UP has stated that just under 10% of its annual revenues, or about \$1 billion (U.S.) is derived from traffic between Mexico and the U.S.; and,
- KCS/Tex-Mex revenues from traffic between Mexico and the U.S. are less than \$70 million annually.

Obviously, UP has enormous economic power in the cross border market. NAFTA Rail will enhance Mexico/U.S. rail competition and provide shippers a strong rail alternative in the future.

Questions?

If you have questions about NAFTA Rail or any of these issues, please contact us at 816-983-1500, or send us an e-mail at NAFTA.Rail@kcsr.com and we will respond promptly. NAFTA Rail will be good for shippers, good for competition, and is in the public interest.



July 9, 2002

NAFTA Railway Partners Reflect and Pursue New Opportunities

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On July 28th, NAFTA Railway alliance partners KCS, TFM and Tex Mex met in Houston for a quarterly meeting to pursue new opportunities for NAFTA Railway growth. Operating, marketing and customer service representatives were present to discuss, among other topics, freight traffic opportunities both north and southbound. All partners agreed that there are tremendous opportunities to grow the business and improve service, especially in conjunction with the recent alliance with BNSF, as well as more established alliances such as those with CN, NS and IMRL.

Recently, the synergies of the three partners have again proven successful with the operational improvements seen on Tex Mex since March. The three groups reported on efficiencies already in effect, such as the consolidation of KCS and Tex Mex dispatching, crew calling and timekeeping to KCS' System Transportation Center in Shreveport.

Since the consolidation, customer service representatives from all three partners, talk weekly about the joint operation. "The team has developed a seamless, one-stop customer service approach for moving traffic in and out of Mexico on the NAFTA Railway," said Jan McNeal, KCS' AVP customer service. "Each week, the team covers service performance related to KCS' new pre-blocking plan for traffic going southbound into Mexico, despacho previo and clearances that will help expedite traffic, technology updates such as Electronic Data Interchange (EDI) performance and billing, as well as current customer issues. The team will continue to resolve issues and provide regular updates to senior leadership."

Since the meeting, KCS and Tex Mex have begun working on an initiative with TFM to create a similar plan for operational efficiency going northbound, to include the possibility of TFM pre-blocking traffic to save handling and transit time on traffic moving from Mexico to the US Markets.

In a final note regarding the NAFTA Railway Alliance meeting, another key topic was that of future projects like the implementation of MCS on KCS this summer and on Tex Mex later this year. The shared computer system will help KCS and Tex Mex to provide more accurate and timely information to customers, and further improve the convenience of doing business on the NAFTA Railway.

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UP Counterpart

PROPORTIONAL RATE AGREEMENT

THIS AGREEMENT made as of this 22^d day of May, 1997, between The Burlington Northern and Santa Fe Railway Company, a Delaware corporation and its railroad affiliates (The Burlington Northern and Santa Fe Railway Company and all of its railroad affiliates, and, where appropriate in the context, their predecessors, are hereinafter referred to collectively as "BNSF"), on the one hand, and Union Pacific Railroad Company, a Utah corporation ("UPRR"), and Southern Pacific Transportation Company, a Delaware corporation ("SP") and all of their railroad affiliates (UPRR, SP and all of their railroad affiliates, and, where appropriate in the context, their predecessors, are hereinafter referred to collectively as "UP"), on the other hand.

WITNESSETH:

WHEREAS, BNSF and UP are parties to an agreement dated September 25, 1995, as supplemented by agreements dated November 18, 1995 and June 27, 1996 (the "Settlement Agreement"), and

WHEREAS, pursuant to Section 2c of the Settlement Agreement, BNSF and UP agreed, using the procedures established in Section 9f of the Settlement Agreement, to establish a Proportional Rate Agreement incorporating the terms of the "Term Sheet for UP/SP-BNSF Proportional Rate Agreement Covering I-5 Corridor" attached as Exhibit B to the Settlement Agreement (the "Term Sheet"), and

WHEREAS, by Letter Agreement dated January 8, 1997 (the "Letter Agreement"), BNSF and UP settled certain disputes regarding the terms of the Proportional Rate Agreement.

NOW, THEREFORE, it is mutually agreed by and between the parties:

1. General.

This Agreement allows UP unilaterally to establish rates for all commodities in all car types moving between (a) BNSF-served facilities or interchanges in the Northern Region as shown on the attached Exhibit A and further defined below and (b) UP origins and destinations or interchanges in the Southern Region as shown on Exhibit A and further defined below. For purposes of this Agreement, (i) "BNSF-served facility" shall mean any facility at which rail traffic originates or terminates now or in the future (including, but not limited to, plants, storage facilities, transload facilities, automobile ramps, intermodal facilities, port facilities, and team tracks), served directly or through any switching arrangement (including, but not limited to, reciprocal switching, joint facility switching, and third party switching) by BNSF regardless of whether the facility is served by more than one railroad but excluding (A) those facilities also served by UP directly, through haulage, or through any switching arrangement as described above and (B) intermodal and transload facilities located now or in the future within 75 miles of a UP served intermodal or transload facility, (ii) "origins" and "destinations" shall mean any point (including, but not limited to, plants, storage facilities, transload facilities, automobile ramps, intermodal facilities, port facilities and team tracks) at which rail traffic originates or terminates, regardless of whether such origins and destinations are served by more than one railroad,

and (iii) "interchanges" shall mean any point of interchange between railroad companies regardless of whether more than one railroad interchanges with the connecting railroad or railroads at the interchange in question. All movements under this Agreement shall be handled in interline BNSF-UP service and be interchanged at Portland, Oregon. Rates shall be available under this Agreement regardless of the route used by UP between Portland and the UP origins, destinations or interchanges in the Southern Region. UP may negotiate with the Canadian National Railway Company ("CN") for an agreement under which proportional rates established under this Agreement can be used directly in conjunction with BCRAIL, Ltd. ("BCOL"). BNSF shall provide reasonable assistance to UP in such negotiation. UP may not establish rates under this Agreement for use directly in conjunction with BCOL until UP has first reached such an agreement with CN.

Northern Region - "Northern Region" shall mean and include all (a) BNSF-served facilities for purposes of determining points to and from which UP can establish rates under this Agreement and all BNSF origins and destinations for purposes of identifying movements of traffic used to calculate rate factors under Section 2, whether served now or in the future in British Columbia, in the State of Washington, in the State of Oregon north of Portland (excluding BNSF-served facilities in Portland and including BNSF's Astoria Branch), in the State of Idaho north of an east-west line drawn through the state at the geographic latitude of Portland, Oregon, and in the State of Montana west of a line drawn through Billings and Havre, (b) existing or future interchanges between Canadian railroads and BNSF for traffic originating or terminating in the Provinces of British Columbia, Alberta or Saskatchewan including, but not limited to, interchanges at

Vancouver, North Vancouver, Brownsville, and New Westminster, British Columbia, at Huntingdon, British Columbia/Sumas, Washington and at Coutts, Alberta/Sweet Grass, Montana, (c) existing or future interchanges with railroads except UP that are line haul carriers participating in interline revenue settlements (such as Central Montana Rail, Inc.) in the State of Washington, in the State of Oregon north of Portland, in the State of Idaho north of an east-west line drawn through the state at the geographic latitude of Portland, Oregon, and in the State of Montana west of a line drawn through Billings and Havre, and (d) origins and destinations on connecting railroads that are not line haul carriers participating in revenue settlements (such as Montana Rail Link) in the State of Washington, in the State of Oregon north of Portland, in the State of Idaho north of an east-west line drawn through the state at the geographic latitude of Portland, Oregon, and in the State of Montana west of a line drawn through Billings and Havre.

Southern Region - "Southern Region" shall mean and include (a) all UP origins and destinations whether served now or in the future by UP in the States of Arizona, California, Colorado, New Mexico, Nevada, Oregon (excluding Portland as an origin or destination and excluding any portion of Oregon included in the Northern Region), Utah and Texas west of a line drawn between Monahans and Sanderson, and including, but not limited to, origins and destinations now or in the future served in common by UP and BNSF (and/or any other railroad) as well as origins and destinations now or in the future served exclusively by UP and (b) existing or future interchanges with (i) Mexican railroads and (ii) other railroads in the states listed above.

For purposes of excluding it from the geographic coverage of this Agreement, "Portland" shall be defined as all stations in Multnomah County, Oregon excluding stations designated by UP Freight Station Accounting Codes ("FSAC") 6248 through 6269.

2. Rate Factors.

a. Rate factors to determine BNSF's revenue for rates established under this Agreement shall be developed on a per net ton-mile basis. Except as provided in Section 2g(4)(a), the rate factors shall be listed in matrices developed and maintained by an independent third party consultant employed by the parties pursuant to Section.

The horizontal axis of each matrix shall list all commodities by three digit Standard Transportation Commodity Code ("STCC"). In the event STCC ceases to be used the parties shall agree on an appropriate substitute that most closely matches STCC. The vertical axis of each matrix shall contain listings for each car type shown on the attached Exhibit B which may be amended from time-to-time to reflect the addition or removal from service of car types at the level of commercial distinction reflected in the exhibit, used in the railroad industry. Separate matrices shall cover southbound movements from and northbound movements to (i) BNSF interchanges with Canadian railroads at or in the vicinity of Vancouver, North Vancouver, Brownsville, and New Westminster, British Columbia and Huntingdon, British Columbia/Sumas, Washington; (ii) BNSF-served origins, destinations, and interchanges north of Seattle, Washington and west of the Cascade Mountain Range; (iii) BNSF origins, destinations, and interchanges south of and including Seattle, Washington and west of the Cascade Mountain Range in the State of Washington and in the State of Oregon north of and excluding Portland;

(iv) BNSF origins, destinations, and interchanges in the State of Washington and in the Province of British Columbia east of the Cascade Mountain Range; and (v) BNSF origins, destinations, and interchanges in the State of Idaho and west of Billings and Havre, Montana, including Sweet Grass, Montana/Coutts, Alberta. For each of these ten geographic combinations, separate matrices shall be prepared for trainload and non-trainload traffic, and for "railroad-owned equipment" as defined in Section 2b(1)(f) below and for "private-owned equipment" as defined in Section 2b(1)(g). Trainload traffic shall mean movements of 67 cars or more of one commodity in one car type. The intersection of each STCC and car type in each matrix is referred to herein as a "cell" of the matrix. Rate factors shall be calculated for each cell as specified in this Section 2. An example of a matrix is attached as Exhibit C to this Agreement.

This Agreement applies to all present and future origins, destinations, and interchanges located within the areas described in subsections 2a(i)-(v). The origins, destinations and interchanges presently covered by this Agreement are listed, to the best of the parties' ability to do so, by four position Standard Point Location Code ("SPLC") and/or BNSF FSAC on the attached Exhibit D which may be amended from time to time as necessary to reflect the addition of origins, destinations and interchanges in the areas described in subsections 2a(i)-(v).

b. The following procedures shall govern the development and maintenance of rate factors:

(1) As used in this Agreement, the terms "equipment allowance," "refunds and rebates," "BNSF single-line traffic," "BNSF-UP interline traffic," "UP

proportional rate traffic," "railroad-owned equipment," and "private-owned equipment" shall have the following meanings:

(a) "Equipment allowance" is any consideration including, but not limited to, cash payments and credits, for use of private-owned equipment.

(b) "Refunds and Rebates" shall include (i) all reductions in revenue, except (A) reimbursements to shippers or other parties for the actual cost of services (e.g., weighing) which relieve BNSF of an obligation to perform such service in connection with providing line-haul rail services, (B) liquidated damages for service failures, (C) switching charges absorbed by BNSF, (D) charges by connecting railroads absorbed by BNSF, and (E) funds advanced to BNSF by a shipper for improvements to railroad facilities serving the shipper and repaid to the shipper in the form of an allowance and (ii) the cost to BNSF of providing any service other than line-haul rail services, including, but not limited to transloading, warehousing, waivers of track lease rent, barge charges and drayage charges. No items within the exceptions to clause (i) shall be treated as a refund or rebate pursuant to clause (ii).

(c) "BNSF single-line traffic" is traffic (excluding movements of company materials, movements of BNSF-UP interline traffic and movements of UP proportional rate traffic) that BNSF handles on a through basis between any BNSF origin, destination, or interchange in the Northern Region and any origin, destination, or interchange in the Southern Region including movements between any of BNSF's affiliated railroads regardless of how the movements between the affiliated railroads are billed. For

purposes of this Agreement "BNSF's affiliated railroads" means any railroad controlled by or under common control with BNSF.

(d) "BNSF-UP interline traffic" is traffic (excluding movements of company materials) that moves between a BNSF origin, destination, or interchange in the Northern Region and a UP origin, destination, or interchange in the Southern Region. BNSF-UP interline traffic must move in interline BNSF-UP service and does not include UP proportional rate traffic.

(e) "UP proportional rate traffic" is traffic moving under rates established pursuant to this Agreement.

(f) "Railroad-owned equipment" is equipment owned or controlled by any railroad company including equipment owned by non-carrier third parties, such as TTX Company, which are typically paid for use of their equipment only by the railroad using the equipment.

(g) "Private-owned equipment" is any equipment that is not railroad-owned equipment, including but not limited to, equipment owned by customers and non-carrier third party lessors, where the railroad using the equipment may be obligated to pay equipment allowances for the use of such equipment.

(2) The rate factor to be included in each cell of a matrix shall be an arithmetic average of the rates for all traffic in the following categories: (i) BNSF single-line traffic, (ii) BNSF interline traffic, and (iii) for only the first eight quarterly matrices developed pursuant to this Agreement, UP proportional rate traffic. The rate factors shall be calculated each calendar quarter of the year using the following methodology:

(a) For each movement of traffic in each of the categories listed in the preceding paragraph determine BNSF's revenue for the commodity, car type, and car ownership in question. Revenue shall be net of all refunds and rebates except in the case of revenue for BNSF single-line traffic reaching an exclusively served UP point in the Southern Region via transload and moving on a single bill of lading and for a single rail price which includes transload and drayage charges for delivery to the UP exclusively served point in the Southern Region. In those cases revenue shall include transloading and drayage charges (but no other charges) required for BNSF single-line traffic to reach such exclusively served UP point in the Southern Region. For traffic moving in railroad-owned equipment, car hire paid by BNSF for use of such equipment shall not be deducted from revenue. For traffic moving in private-owned equipment, equipment allowances paid by BNSF for use of such equipment shall be deducted from revenue. The amount of the equipment allowance deducted from BNSF revenue for traffic moving in private-owned equipment shall be the actual equipment allowance paid by BNSF. BNSF shall continue to pay reimbursements, allowances and charges described in Section 2b(1)(b)(A), (C), (D), and (E) (which, as provided in Section 2b(1)(b), are not to be deducted from revenue) on traffic moving under this Agreement on the same terms and conditions as it absorbs those charges for BNSF single-line and BNSF-UP interline traffic. The revenue data (net of all refunds and rebates) included in the computation shall be the most current available single-line and settled interline revenues on a per-car basis for movements in the calendar quarter immediately preceding the calendar month in which the computation is made.

(b) Determine for (i) BNSF single-line traffic, BNSF's official distance between each BNSF origin or interline junction and each BNSF destination or interline junction for the traffic in question as published in BNSF's Mileage Tariff BN 6003 Series or the then current mileage guide ("BNSF's Mileage Tariff"), (ii) BNSF-UP interline traffic, BNSF's official distance between each BNSF origin, destination, or interline junction and the BNSF-UP interline junction for the traffic in question as published in BNSF's Mileage Tariff; and (iii) UP proportional rate traffic, BNSF's official distance between each BNSF origin, destination, or interline junction and Portland, Oregon as published in BNSF's Mileage Tariff. When connecting railroad revenues are included in BNSF's revenue (i.e., BNSF has authority to quote rates for the connecting railroad and the connecting railroad is not a linehaul carrier participating in revenue settlements), the connecting railroad's mileage shall also be included in the BNSF route mileage.

(c) Identify net tons for each move using the lading weight used in calculating freight charges where weight is used for billing purposes or, in the case of traffic moving pursuant to a rate per car, a weight agreed upon by UP and BNSF. If the foregoing measure of lading weight is not available, the actual lading weight shall be used. If the actual lading weight is not available, estimated lading weight shall be used. When estimated lading weights are used they shall be the same estimates as used for other business purposes associated with the traffic in question, e.g., billing, revenue accounting, and operating systems. If none of the foregoing measures are available, net tons shall be measured by the weight capacity of the car or intermodal unit handling the move in question as identified in the Universal Machine Language Equipment Register ("UMLER").

In the event UMLER ceases to be published, the parties shall determine the most appropriate substitute that most closely matches UMLER.

(d) Using the data developed in steps (a) through (c) above calculate the per net ton-mile rate for each movement in each cell. The per net ton-mile rate shall be rounded to a hundredth of a cent. The rounding rule shall be that any fraction less than one half shall be dropped while any fraction equal to or greater than one-half shall be rounded up to the next higher value.

(e) Calculate an arithmetic average of the per net ton-mile rates resulting from step (d) above for each cell.

c. Rate matrices shall become effective two months after the end of the preceding calendar quarter. BNSF and UP agree to provide the third party consultant with the data needed to compute the rate factors in sufficient time to allow the consultant to issue updated rate matrices at least thirty days after the start of the calendar quarter in which such updated rate matrices are to become effective. Once a matrix is issued and until the matrix is updated, UP may use the rate factors in that matrix to establish rates for traffic moving on or after the effective date of the matrix.

d. UP may establish rates under this Agreement in any manner, including, but not limited to, tariffs, contracts, letter quotes, and exempt circulars, provided, however, that UP may not establish rates for handling by BNSF of traffic in the account of a railroad other than UP, and provided further that such tariffs, contracts, letter quotes and exempt circulars shall not, without BNSF's prior consent, impose any obligation on BNSF beyond those established by this Agreement. UP shall have the right to establish rates for

movement in private equipment which may or may not include a mileage allowance, provided that if a rate does include a mileage allowance, UP shall fully defray any mileage payment while the car is on BNSF lines in the Northern Region. The amount paid to BNSF shall be derived (i) for rates established pursuant to contract, from the rate factor in place as of the effective date of the contract and (ii) for rates established pursuant to tariff, letter quote, exempt circular or other mechanism establishing a rate, from the rate factor in place as of the date traffic is tendered (i.e., waybill date) by a customer for movement. The rate factor from which the payment to BNSF is derived for rates established pursuant to contract shall be adjusted in accordance with any adjustment provision included in the contract.

e. If no movements of traffic have taken place for any given cell, the cell shall remain empty until a BNSF single-line or a BNSF-UP interline movement takes place for the commodity and car type creating the cell. However, once a cell has been filled with a rate factor, it shall remain filled. When a rate factor in a cell has not been changed by virtue of a new movement or movements taking place in the preceding quarter, the rate factor in such cell shall be adjusted, using (a) the average rate of change between the preceding and second preceding quarter in the values in the same column of the matrix (i.e., for the same 3-digit STCC code) for which there are new data, or, if this procedure is not applicable because there are no cells in the column with new data, (b) the average rate of change between the preceding and second preceding quarter in the value of all cells in the row of the matrix (i.e., for the same car type) for which there is new data.

f. Should BNSF on its own or at the request of UP establish rates in the future based on factors other than weight, distance, car type or commodity (including but not limited to, the charges for handling by BNSF of traffic in the account of another railroad (i.e., "haulage")), such rates shall be included in the calculation of separate matrices to be used by UP pursuant to this Agreement.

g. (1) Except as provided in Section 2b(2)(c) where estimated weights may be used, this Agreement contemplates that the data used to compute rate factors pursuant to Section 2b(2) shall be actual data. The parties agree that during the Interim Period, as defined below, estimates of rates, equipment allowances, refunds and rebates, mileage, and weights may be used in lieu of actual data. BNSF agrees that the estimates it uses shall be the best estimates available to BNSF and the same estimates that are used for other business purposes at BNSF.

(2) "Interim Period" shall mean the period between (i) the date UP and BNSF close the Keddie-Bieber sale, implement the Chemult-Bend trackage rights, and implement this Agreement as called for in Section 2 of the Settlement Agreement, and (ii) the date BNSF is able to compute rate factors pursuant to Section 2b(2) using actual data.

(3) BNSF agrees to move forward diligently to continue refining the accuracy of its estimating systems used to produce the rate matrix and within 24 months, unless waived by UP, to develop systems necessary to produce a rate matrix derived from actual, rather than estimated data.

(4) During the Interim Period, BNSF shall develop estimated data as described above for the production of rate matrices pursuant to Section 2b(2) and with the following modifications to the procedures in Section 2b(2).

(a) The initial matrix shall be the attached Exhibit E. Updated matrices may be issued by BNSF until the third party consultant is able to begin developing and maintaining the matrices. BNSF and UP agree to provide the third party consultant with the data needed to compute the rate factors for subsequent matrices during the Interim Period in sufficient time to allow the third party consultant to issue updated rate matrices at least 30 days after the start of the calendar quarter in which such updated matrices are to become effective.

(b) New rate matrices shall be developed every quarter during the Interim Period and shall become effective on the later of (i) two months after the end of the preceding calendar quarter or (ii) 15 days (or less, at BNSF's option) after UP substitutes a rate factor or provides additional data as specified in Section 2g(4)(c). The rate matrices shall be derived from data for the calendar quarter immediately preceding the calendar quarter in which the matrix becomes effective. For example, the first updated matrix shall be provided to UP on August 1, 1997 and shall be effective on September 1, 1997. That matrix shall be derived from data for the preceding April, May and June, 1997.

(c) During the first 24 months of the Interim Period, UP shall have the right to substitute a rate factor from the original matrix for a rate factor in the same cell of any subsequent matrix. Any rate factor substituted by UP under the provisions of this Section 2g(4)(c) shall be adjusted in the manner provided in Section 2e.

UP shall also have the right to provide additional rate data which shall be used to recompute the rate factor in any cell of an updated rate matrix based upon UP's additional data and the data used by BNSF. Any substitution of a rate factor or the provision of additional data must be completed no later than 15 days after the rate matrix is issued.

3. Service Standards.

BNSF shall supply and distribute equipment and shall accept, handle, switch and deliver traffic moving under this Agreement without any discrimination whatsoever, including, but not limited to, in promptness, quality of service or efficiency, for both loaded and empty equipment, in favor of comparable traffic moving in BNSF's account. BNSF shall adopt no policies, including but not limited to demurrage and absorption of switching fees or shortline connection fees, that discriminate in any way against traffic moving under this Agreement, provided, however, that BNSF may grant its customers relief from the application of a particular policy on a case-by-case basis if granting such relief is consistent with business practice in the railroad industry and is not used to defeat the requirements of this Agreement not to discriminate against traffic moving under this Agreement. BNSF and UP shall cooperate to establish necessary blocks to provide efficient and competitive service on traffic moving under proportional rates pursuant to this Agreement. To the extent justified by business volumes, BNSF shall continue operating Vancouver, British Columbia-Portland (SPT interchange) trains comparable to BN Nos. 111 and 112 as of September 25, 1995.

4. Equipment Supply.

a. BNSF shall have the same obligation to supply equipment (including, but not limited to, as regards quantity, quality and type) for traffic moving under this Agreement as it has for traffic that does not move under this Agreement.

b. Requests for cars for loading shall be received by BNSF personnel from customers and handled pursuant to the procedures specified in AAR Car Service Rule 15. In the event AAR Car Service Rule 15 ceases to be used the parties shall agree on an appropriate substitute that most closely matches AAR Car Service Rule 15. BNSF shall not require customers to indicate when ordering equipment whether a car shall be used to handle traffic moving under rates established pursuant to this Agreement but may require specific destinations and routing information in accordance with BNSF's customary car ordering procedures. Customers whose traffic moves under this Agreement shall also be permitted to contact UP to order cars. UP shall promptly advise BNSF of the car order and whether it wishes BNSF to fill the car order or whether UP shall provide equipment for such order under the provisions of Section 4c.

c. UP shall have the right, but not the obligation, to provide equipment for any traffic which can move under rates established pursuant to this Agreement. When UP provides equipment, UP shall provide BNSF with information that meets BNSF's car ordering requirements necessary to handle the traffic in question and BNSF agrees to accept the equipment supplied by UP at any interchange between UP and BNSF in response to such orders, provided that the mileage between the interchange in question and the BNSF origin in the Northern Region is no greater than the BNSF mileage between

Portland, Oregon and the origin in question. BNSF shall provide trackage at strategically located car distribution points in the Northern Region to stage UP supplied equipment ordered by customers. Such trackage shall be provided by BNSF at no charge provided, however, that BNSF shall have no obligation to store UP equipment without charge unless such equipment is applied to specific orders for UP supplied equipment.

d. Subject to applicable AAR Car Service Rules, Car Service Directives, and bilateral agreements governing the payment of car hire, the parties shall be responsible for all car hire charges while such cars are on their respective lines.

e. All empty equipment shall be returned by UP or BNSF pursuant to this Agreement, as the case may be, in accordance with applicable AAR Car Service Rules, Car Service Directives and bilateral agreements between UP and BNSF governing the handling of equipment.

f. The parties agree to develop and refine procedures for receiving car orders as necessary to address any inefficiencies that may occur such as duplicate car orders.

5. Billing and Payment.

The parties agree to develop and refine procedures to ensure the efficient processing and exchange of information needed to administer this Agreement. The initial accounting and billing procedures are described on the attached Exhibit F which may be amended from time to time to reflect new and refined procedures developed by the parties as provided in the preceding sentence.

In order to preserve the confidentiality of UP's rates, UP may elect to utilize an agent to handle billing and payment. The agent shall, among other things, issue and receive bills of lading, apply any transportation service contract escalation provisions, issue freight bills to customers, and collect freight payments from customers.

The amount to be paid to BNSF for a particular movement subject to this Agreement shall be derived by multiplying (i) the applicable rate factor by (ii) the net tons shipped by (iii) BNSF's official distance as published in BNSF's Mileage Tariff between the BNSF interline junction, origin or destination on the one hand and Portland, Oregon, on the other hand. Lading weights used to calculate net tons for billing purposes shall be derived in the same manner as specified in Section 2b(2)(c).

Payments to BNSF shall be made by UP or its agent within 15 days after the end of the preceding month. Payment shall cover movements during the preceding month for which UP has received waybills.

6. Third Party Consultant.

The parties may use a third party consultant or consultants to develop and maintain the rate matrices pursuant to this Agreement. The third party consultant shall be jointly employed by BNSF and UP and be required to remain impartial between BNSF and UP. Each party may request the third party to prepare reports using data derived from the rate matrices, provided that (1) such report shall not disclose to UP or BNSF information about the volume of the other's business, (2) the party requesting such report shall be solely responsible for the cost of preparing such report, and (3) such report shall be shared with the other party upon payment by the other party to the party requesting the

report of one half the cost of such report. Within two weeks after being requested by one party to prepare a report, the third party shall give the other party written notice of the request to prepare a report. The third party consultant shall be terminated for any breach of the impartiality requirement of this Section 6 and may also be terminated by mutual agreement of the parties.

7. Right to Audit.

Each party shall have the right to audit, at all reasonable times, so much of the books, accounts and records of the other party as are related to the data required to be supplied by them under the terms of this Agreement. Except as provided below, the expense of any such audit shall be borne by the party undertaking the audit unless errors or information are discovered that have a material adverse effect on the party conducting the audit in which case the party in whose records the errors or information were discovered shall bear the entire expense of the audit.

The right to audit includes the right by either party to require a complete or partial (one or more cells) audit of the rate matrices. The expense of any audit of the rate matrices shall be split evenly between UP and BNSF. When rate factors in a cell or cells of a matrix are found to be in error, the rate factors shall be corrected to reflect accurate data as determined by the audit and the corrected rate factors shall remain in place and unchanged until BNSF or UP, as the case may be, can demonstrate that it has more accurate data to update the rate factor or factors found to be inaccurate. If upon audit, (a) a rate factor derived from BNSF data is found to exceed the rate factor computed using data developed in the audit by 20% or more, or (b) a rate factor derived from UP data is

found to be 20% or more below the rate factor computed using data developed in the audit, then the party whose rate data was inaccurate agrees to reopen to competitive bidding any contracts entered into by such party for the pertinent traffic on the basis of competitive bidding between UP and BNSF while the inaccurate rate factor was in effect, and UP and BNSF may bid on such contract with UP using the corrected rate factor.

BNSF shall have the right to cause an audit by a disinterested third party as provided below, at all reasonable times, of the books, accounts and records of the agent retained by UP to handle billing and payment pursuant to Section 5. BNSF shall bear the expense of any such audit unless material errors are discovered upon audit in which case UP shall bear the entire expense of the audit.

Any audit of the books and records of the third party consultant employed by the parties pursuant to Section 6 of the Agreement shall be a joint audit and the cost of the audit shall be split equally between UP and BNSF.

To the extent any audit requires access to confidential information, the parties agree to enter into an appropriate confidentiality agreement and, if necessary to preserve confidentiality, to use a disinterested third party such as a national accounting firm to conduct such audit. Each party and their agents shall retain, for at least five years, the books, accounts and records used to develop information necessary for the operation of this Agreement.

8. Settlement Agreement.

The terms of the Settlement Agreement, as amended and supplemented from time to time, and to the extent that such terms are not contradictory or inconsistent with the Letter Agreement or this Agreement, shall survive the parties' entry into this Agreement.

9. Arbitration.

All disputes under this Agreement shall be referred to binding arbitration under Section 15 of the Settlement Agreement.

10. Term.

This Agreement shall become effective upon the first day of the Interim Period and shall continue for a term of 99 years and thereafter, subject to renegotiation after 99 years as described below, for so long as BNSF or any other party operates a route between the general vicinity of Bieber and the general vicinity of Stockton wholly within the State of California. After 99 years, the Agreement shall, at the request of either UP or BNSF, be renegotiated to determine terms for continuation of the Agreement in accordance with the purposes of the Agreement and conditions and circumstances at the time of renegotiation, including any then revised conditions of BNSF's operations between Bieber and Stockton. Any disputes over the renegotiation of the terms for continuation of the Agreement shall be submitted to arbitration. This Agreement shall terminate if BNSF shall no longer be able to enter into through rates, haulage or any other transportation arrangement between BNSF points in the Northern Territory and BNSF points in the Southern Territory over a route crossing the Oregon-California border, via either its own lines or those of a railroad other than UP. This Agreement also may be terminated at any

time by (i) mutual consent of the parties or (ii) UP's election to terminate this Agreement by giving one year written revocable notice.

11. Successors and Assignability.

This Agreement shall be binding upon and inure to the benefit of the parties and their respective successors, lessees and assigns. This Agreement is not assignable without written consent of either party, except that either party may assign the Agreement in the event of a sale, assignment, mortgage, or lease of its entire railroad. In the event BNSF sells or leases part or all of its lines in the Northern Territory, BNSF agrees that any such sale or lease shall be subject to this Agreement to the extent BNSF retains the exclusive authority to quote rates for traffic moving subject to this Agreement to and from points on such lines. If BNSF does not retain exclusive authority to quote rates for traffic moving subject to this Agreement to and from points on such lines, BNSF agrees that any such sale or lease shall not be structured in a manner, and that BNSF shall not take any action, that would in any way inhibit or prevent the purchaser or lessee from working with UP to handle in any manner, including on an interline, haulage, proportional rate or any other manner traffic subject to this Agreement originating or terminating on the lines sold.

UP's rights under this Agreement with respect to traffic moving subject to this Agreement to and from points on such a sold or leased line shall be satisfied if (i) proportional rates under this Agreement apply to points on such lines or (ii) UP has direct access or access via interchange (with interchange handled by BNSF for a fee equal to the handling charges called for in haulage agreements entered into between UP and BNSF in connection with implementation of the Settlement Agreement) to the shortline for

traffic covered under this Agreement or (iii) proportional rates under this Agreement apply to the junction with the shortline, and in the case of (ii) or (iii), BNSF has not inhibited or prevented the shortline from working with UP to handle traffic subject to this Agreement in any manner.

12. Miscellaneous.

a. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

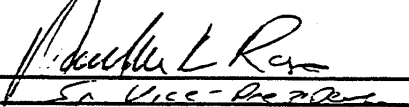
b. When the context requires, singular nouns include the plural and conversely, when plural nouns are used they shall include the singular.

IN WITNESS WHEREOF, the parties have caused this Proportional Rate Agreement to be fully executed as of the date first above written.

UNION PACIFIC RAILROAD COMPANY

THE BURLINGTON NORTHERN AND
SANTA FE RAILWAY COMPANY

By: 
Title: Executive Vice President -
Marketing & Sales

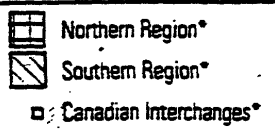
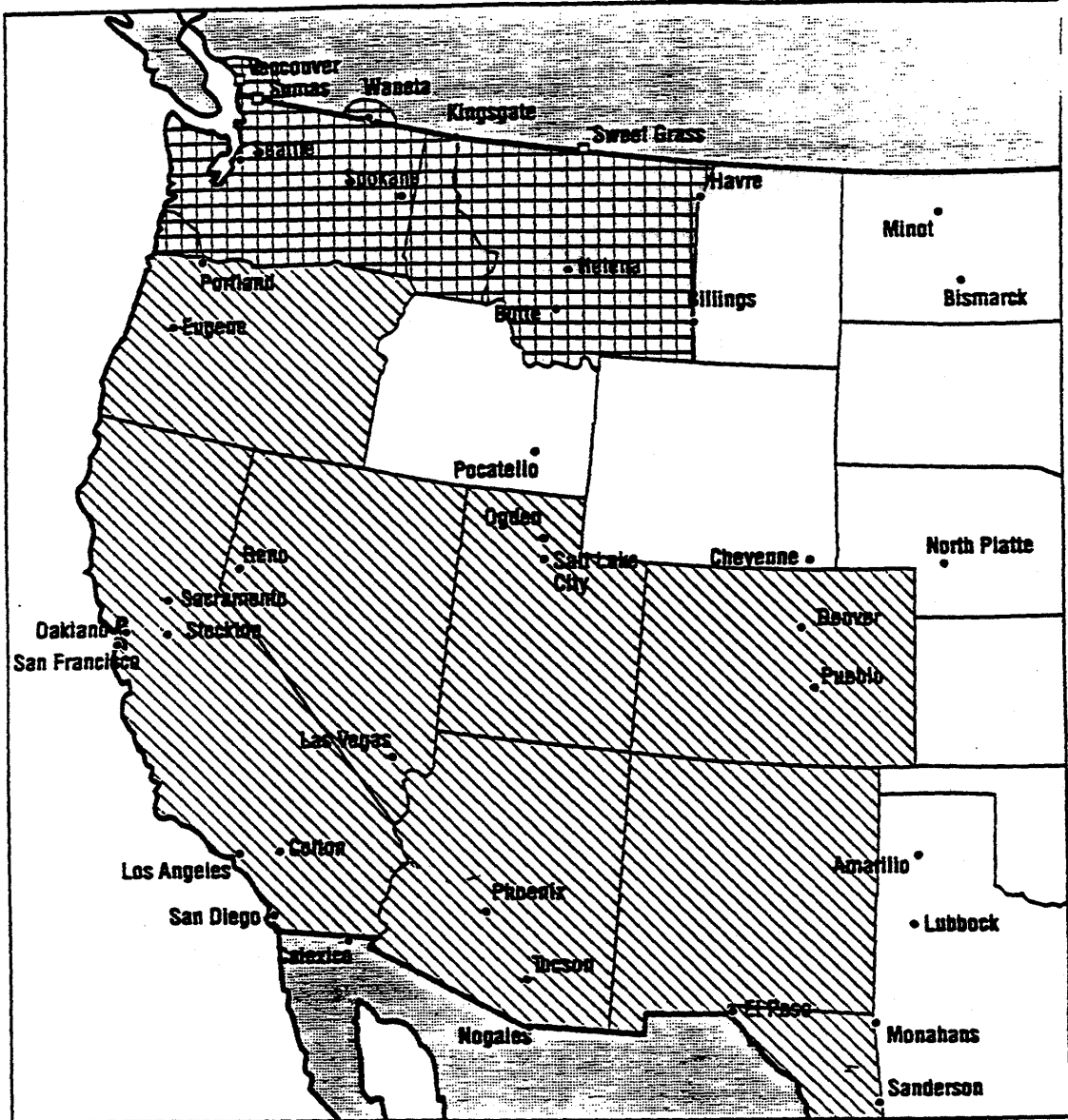
By: 
Title: Sr. Vice President

SOUTHERN PACIFIC TRANSPORTATION
COMPANY

By: 
Title: Executive Vice President -
Marketing & Sales

Exhibit A

UP/SP I-5 Proportional Rate Agreement



* Points and interchanges are for geographic reference only and do not define origins, destinations and interchanges covered by this Agreement

**Car Type Designation
for I-5 Proportional Rate****

A
B
C (Other than C1, C2, C3)
C1
C2
C3
D
E
F
G
H
J
K
L
M
P
Q
RB (RX0X, RX1X)
RM (RX5X, RX6X, RX7X, RX8X, RX9X)
S
T
U (Other than U2, U5, U7)
U2*
U5*
U7*
V
Z (Other than Z2, Z5, Z7, Z9)
Z2*
Z5*
Z7*
Z9*

* Need separate cell for well cars vs. conventional flat.

** Car type designations will be changed from time-to-time to reflect the addition or removal from service of car types, at the level of commercial distinction reflected in this exhibit, used in the railroad industry. These car type designations are taken from UMLER. If UMLER ceases to be published the parties will agree on a means of designating car types that most closely matches the designations drawn from UMLER.

[Exhibit C Not Provided]

**Origins, Destinations and Interchanges Included
in the Areas Described in Subparagraphs 2a(i)-(v)**

Subparagraph 2a

Points by SPLC and/or FSAC

- (i) BN FSAC: 15091-15150; 66504; 66565; 66089; 66095
All interchanges at these FSACS
- (ii) SPLC 8441, 8443, 8446, 8447 and 845112, 845114, and 845115
- (iii) SPLC 8467, 8463, 8460, 8461, 8462, 8450, 8451 (except 845112, 845114 and 845115), 8452, 8453, 8491, 8494, 8496, 8499, 8531, 8532, and 853413
- (iv) 1356-1394; 11011, 11021, 32561-32590; 30854, 30836, 32557

BN FSAC: 62126-62185; 62235-62247; 99460, 61239

SPLC: 8401, 8403, 8411, 840522, 840523, 840555, 840573, 840518, 840516, 840514, 840513

8301, 8303, 8307

71, 7031, 7033, 7035, 7036, 7037, 7067, 7061, 7064, 7057, 7092, 7091, 7096, 7094
- (v) SPLC: All remaining SPLC's in Washington and Idaho

This Exhibit will be modified from time-to-time as necessary to reflect the addition of origins, destinations and interchanges in the areas described in subsections 2a(i)-(v).

[Exhibit E Not Provided]

May 22, 1997

EXHIBIT F
ACCOUNTING AND BILLING PROCEDURES

BNSF Proportional Rate Alternatives Selected for Implementation

I ORIGINATING ON BNSF OR TERMINATING ON BNSF IN NORTHERN TERRITORY

A. Procedures for BNSF Proportional Rate Traffic when BNSF, or a BNSF handling carrier, Originates the Shipment in the Northern Territory

Details for Southbound Moves:

1. No BNSF PNW stations need to be adopted by the UP. UP (and connections other than BNSF, if any) establishes through rate by contract, confidential letter quote or tariff via a BNSF-Portland-UP-Destination or Interchange route which stipulates that UP will arrange for service over the BNSF portion of the route; the rate matrix is the BNSF Rule 11 contract rate with UP.
2. Car Orders - to BNSF (subject to Section 4. Equipment Supply in the Agreement)
3. Car Releases - to BNSF
4. Bill of Lading - to BNSF showing I-5 indicator (i.e., reference to UP I-5 rate authority).

As per AAR Accounting Rule 11 B. (3), BNSF will generate a Rule 11 '417' waybill showing UP as the patron responsible for payment of BNSF's freight charges and the consignee or consignor (as the case may be) as the patron responsible for payment of the through freight charges.

If customer does not provide the I-5 Indicator, BNSF will generate a revenue waybill for the shipment as an Interline Settlement Movement subject to correction as per AAR Accounting Rule 61. In the event a movement which should have moved under a through rate created under this Agreement is settled between BNSF and UP through interline settlement, BNSF and UP shall settle any discrepancies, including but not limited to duplicate payments, through overcharge claim channels within six months of the waybill date.

5. BNSF creates '417' transportation waybill with the I-5 indicator, a movement route of BNSF to Portland with BNSF flagged as a Rule 11 carrier, and BNSF sends a '417' waybill to other roads in the route.
6. BNSF creates a "parent" Rule 11 '426' waybill and sends it to Central ISS.
7. UP concurs to the "parent" Rule 11 entry in ISS.
8. If UP or a UP "handling" carrier is the destination carrier, UP creates a revenue '426' waybill without BNSF in the revenue route, from Portland to destination showing a prior or true origin as the origin location for the shipment. If another interline carrier terminates the shipment, that

destination carrier creates a revenue '426' "child" waybill with a Rule 11 entry in ISS for the route north of Portland.

9. If the shipment is prepaid, UP creates freight bill and bills the customer the through rate. If the shipment is collect, the destination interline carrier creates freight bill and bills the customer the through rate.
10. BNSF does not bill customer for its Rule 11 portion and does not create a Rule 11 "child" waybill in ISS.
11. UP pays BNSF its proportional rate for its Rule 11 move to Portland. As soon as practicable, payment shall be electronically.
12. If other interline railroads are involved, (e.g., SP/UP) settling carrier pays other roads their divisions or factors as agreed between UP and the connections.
13. BNSF pays car hire for its segment of the move.
14. Freight claims will be handled in accordance with AAR Accounting Rule 116. Any unallocated claims shall be allocated in accordance with the AAR Freight Claim Rules.

- B. Procedures for BNSF Proportional Rate Traffic when BNSF, or a BNSF handling carrier, Terminates the Shipment in the Northern Territory and when UP/SP, or a UP/SP handling carrier, Originates the Shipment in the Southern Territory

Details for Northbound Moves:

1. No BNSF PNW stations need to be adopted by the UP. UP establishes through rate by contract, confidential letter quote or tariff via a Origin-UP-Portland-BNSF-Destination route which stipulates that UP will arrange for service over the BNSF portion of the route; the rate matrix is the BNSF Rule 11 contract rate with UP.
2. Car Orders - to UP
3. Car Releases - to UP
4. Bill of Lading - to UP showing I-5 indicator (i.e., UP I-5 rate authority).
As per AAR Accounting Rule 11 B. (3), UP will generate a Rule 11 '417' waybill showing UP as the patron responsible for payment of BNSF's freight charges and the consignee or consignor (as the case may be) as the patron responsible for payment of the through freight charges.
If customer does not provide the I-5 Indicator, and UP does not initially generate a Rule 11 waybill, UP may issue a corrected waybill in accordance with AAR Accounting Rule 61. In the event a movement which should have moved under a through rate created under this Agreement is settled between BNSF and UP through interline settlement, BNSF and UP shall settle any discrepancies, including but not limited to duplicate payments, through overcharge claim channels within six months of the waybill date.

5. UP creates a '417' transportation waybill with the I-5 indicator, a route of UP-Portland-BNSF with BNSF flagged as a Rule 11 carrier, and sends to other roads in the route.
6. UP creates a "parent" Rule 11 '426' waybill and sends it to Central ISS.
7. BNSF concurs to the "parent" Rule 11 entry in ISS.
8. UP creates revenue waybill without BNSF in the revenue route, from the origin to Portland with an ultimate or true destination as the destination location for the shipment; but if UP and SP are both in the route, then UP will create the necessary "child" waybills.
9. UP creates freight bill and bills the customer the through rate.
10. BNSF does not bill the customer for its Rule 11 portion.
11. UP pays BNSF its proportional rate for its Rule 11 move from Portland. As soon as practicable, payment shall be electronically.
12. BNSF pays car hire for its segment of the move.
13. Freight claims will be handled in accordance with AAR Accounting Rule 116. Any unallocated claims shall be allocated in accordance with the AAR Freight Claim Rules.

- C. Procedures for BNSF Proportional Rate Traffic when BNSF, or a BNSF handling carrier, Terminates the Shipment in the Northern Territory and when an Interline Carrier Originates the Shipment in the Southern Territory

Details for Northbound Moves:

1. No BNSF PNW stations need to be adopted by the UP. UP and its connections establish through rates by contract, confidential letter quote or tariff via a Origin-Connection-Interchange-UP-Portland-BNSF route which stipulates that UP will arrange for service over the BNSF portion of the route; the rate matrix is the BNSF contract Rule 11 rate with UP.
2. Car Orders - to Origin Interline Carrier
3. Car Releases - to Origin Interline Carrier
4. Bill of Lading - to Origin Interline Carrier showing I-5 indicator (i.e., UP I-5 rate authority)

As per AAR Accounting Rule 11 B. (3), Origin Interline Carrier will generate a Rule 11 '417' waybill showing UP as the patron responsible for payment of BNSF's freight charges and the consignee or consignor (as the case may be) as the patron responsible for payment of the through freight charges.

If customer does not provide the I-5 Indicator, Origin Interline Carrier will generate a revenue waybill for the shipment as an Interline Settlement Movement subject to correction as per AAR Accounting Rule 61. In the event a movement which should have moved under a through rate created under this Agreement is settled between BNSF and UP through interline settlement, BNSF and UP shall settle any discrepancies, including but not

limited to duplicate payments, through overcharge claim channels within six months of the waybill date.

5. Interline Origin Carrier creates '417' transportation waybill with the I-5 indicator, and a route of Origin-Interline Origin Carrier-Interchange-UP-Portland-BNSF with BNSF flagged as a Rule 11 carrier, and sends to other roads in the route.
6. Origin Interline Carrier creates a "parent" Rule 11 waybill and sends to Central ISS.
7. BNSF concurs to the "parent" Rule 11 entry in ISS.
8. Origin Interline Carrier creates revenue waybill without BNSF in the revenue route from the origin to Portland with an ultimate or true destination as the destination location for the shipment.
9. If prepaid, the Origin Interline Carrier creates freight bill and bills the customer the through rate. If collect, UP creates the freight bill and bills the customer the through rate.
10. BNSF does not bill the customer for its Rule 11 portion.
11. UP pays BNSF its proportional rate for its Rule 11 move from Portland. As soon as practicable, payment shall be electronically. UP and Origin Interline Carrier settle through interline settlement procedures.
12. BNSF pays car hire for its segment of the move.
13. Freight claims will be handled in accordance with AAR Accounting Rule 116. Any unallocated claims shall be allocated in accordance with the AAR Freight Claim Rules.

II TRAFFIC MOVING OVERHEAD ON BNSF IN NORTHERN TERRITORY

Procedures for BNSF Proportional Rate Traffic if BNSF, or a BNSF handling carrier, bridges traffic through the Northern Territory via Portland

A. Details for Southbound Moves:

1. UP adopts the BNSF interchange stations with the Northern Territory Interchange Carriers (e.g., CN, CM, CP, etc.) Origin Carrier or UP establishes a through rate in contract, letter quote or tariff with a route showing UP as serving the adopted interchange location.
2. Car Order - to Origin Carrier
3. Car Release - to Origin Carrier
4. Bill of Lading - to Origin Carrier showing I-5 indicator (UP I-5 rate authority or adopted junction).

If customer does not provide the I-5 indicator, any waybills are subject to correction as provided by AAR Accounting Rule 61. In the event a movement which should have moved under a through rate created under this Agreement is settled between BNSF and UP through interline settlement, BNSF and UP shall settle any discrepancies, including but not

limited to duplicate payments, through overcharge claim channels within six months of the waybill date.

5. Origin Carrier creates '417' transportation waybill with the I-5 indicator, an operating route of Origin Carrier-Adopted Interchange-BNSF-Portland-UP with BNSF flagged with an IMA=HM "handling" segment and the R2 BNSF segment flagged as "H", and sends to other roads in the route.
6. Settling carrier (origin if prepaid and destination if collect) creates a revenue waybill without BNSF in the route, UP replaces BNSF in the revenue route.
7. Settling carrier (origin if prepaid and destination if collect) creates a freight bill and bills the customer the through rate.
8. BNSF systems will not expect nor look for a revenue waybill reporting in ISS.
9. UP pays BNSF a proportional rate for its "handling" service in the Northern Territory. As soon as practicable, payment shall be electronically.
10. For the other interline carriers in the route in the '426' waybill, the settling carrier pays the interline carriers their proportion through the normal ISS settlement process.
11. BNSF pays car hire for its segment of the move.
12. Freight claims will be handled in accordance with AAR Accounting Rule 116. Any unallocated claims shall be allocated in accordance with the AAR Freight Claim Rules.

B. Details for Northbound Moves:

1. UP adopts the BNSF interchange stations with the Northern Territory Interchange Carriers (e.g., CN, CM, CP, etc.). Destination Carrier or UP publishes a through rate in contract, letter quote or tariff with UP serving the adopted interchange location.
2. Car Order - to Origin Carrier
3. Car Release - to Origin Carrier
4. Bill of Lading - to Origin Carrier showing I-5 indicator, UP I-5 rate authority or adopted junction.

If customer does not provide the I-5 indicator, any waybills are subject to correction as provided by AAR Accounting Rule [71]. In the event a movement which should have moved under a through rate created under this Agreement is settled between BNSF and UP through interline settlement, BNSF and UP shall settle any discrepancies, including but not limited to duplicate payments, through overcharge claim channels within six months of the waybill date.
5. Origin Carrier creates '417' transportation waybill with the I-5 indicator, a route of Origin-UP-Portland-BNSF-Adopted Interchange-Destination carrier with BNSF flagged with an IMA=HM segment and the R2 BNSF segment flagged as "H", and sends it to other roads in the route.

6. Settling carrier (origin if prepaid and destination if collect) creates a revenue waybill without BNSF in the route. UP or SP replaces BNSF in the revenue route.
7. Settling carrier (origin if prepaid and destination if collect) creates a freight bill and bills the customer the through rate.
8. BNSF systems will not expect nor look for a revenue waybill reporting in ISS.
9. UP pays BNSF a proportional rate for its "handling" service in the PNW. As soon as practicable, payment shall be electronically.
10. If other interline carriers are in the route, settling carrier pays other roads their proportion through the normal ISS settlement process.
11. BNSF pays car hire for its segment of the move.
12. Freight claims will be handled in accordance with AAR Accounting Rule 116. Any unallocated claims shall be allocated in accordance with the AAR Freight Claim Rules.

In the event AAR Accounting Rules or AAR Freight Claim Rules cease to be used or are modified, the parties shall agree on an appropriate substitute that most closely matches the AAR Accounting Rules, AAR Freight Claim Rules, or particular Rule, as the case may be.

Barley

**VERIFIED STATEMENT
OF
STEPHEN R. BARKLEY**

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**VERIFIED STATEMENT
OF
STEPHEN R. BARKLEY**

My name is Stephen R. Barkley. I am Regional Vice President - Southern Region of Union Pacific Railroad Company ("UP"). My office is located at 24125 Aldine Westfield Road, Spring, Texas 77373. I have held my current position since January 1998.

I joined UP from Illinois Central Railroad in 1980. From 1980 to 1989, I held positions in the UP Operating Department, including several trainmaster positions, Director of Train Management, and Manager of Train Operations. In 1989 and 1990, I worked in UP's Marketing and Sales Department, initially as Director of the National Customer Service Center and subsequently as General Director of Service Design. I then returned to the Operating Department, serving as Division Superintendent in Stockton, California and Houston, Texas. From 1994 to 1996, I served as General Manager of the Southern Region. In 1996 and 1997, I was Assistant Vice President in charge of the Harriman Dispatching Center in Omaha.

In my position as Regional Vice President - Southern Region, I am responsible for management of UP's operations in the States of Texas, Oklahoma, and Louisiana. In connection with my duties in my current position and prior positions since 1994, I have become familiar with operations on UP's lines in these states and with operations at UP's border crossings between Texas and Mexico.

Kansas City Southern has recently announced that it intends to create Nafta Rail through acquisition of control of both The Texas Mexican Railway Company ("Tex Mex") and TFM, S.A. de C.V. ("TFM"), a Mexican railroad. I am submitting this

statement to explain UP's concerns about the effect of the proposed Nafta Rail transaction on operations at the International Railroad Bridge, which connects the United States and Mexico at Laredo, Texas, and Nuevo Laredo, Mexico. I suggest how the Board should frame conditions to ensure fair treatment of all railroads at the Bridge. In addition, I address comments Applicants have made about Tex Mex operations over UP lines in Texas under trackage rights granted in connection with approval of the 1996 merger of UP and Southern Pacific Transportation Company ("SP").

I. LAREDO BRIDGE

The International Railroad Bridge at Laredo, Texas ("Laredo Bridge" or "Bridge"), which spans the Rio Grande River, is a crucial link for rail transportation between the United States and Mexico. Of the multiple rail border crossings between the United States and Mexico, the Laredo crossing has the highest volume of rail traffic moving between the two countries. TFM, the successor to the northeast portion of the National Railways of Mexico, owns the southern half of the Laredo Bridge. Tex Mex owns the track on the northern half of the Bridge and the approach track at the north end of the Bridge, while Mexrail (owner of Tex Mex) owns the bridge structure on the northern half. The connection between the U.S. railroads and the TFM system is at the middle of the Bridge. Exhibit A to this statement is a schematic of the Laredo Bridge and nearby tracks.

Importance of Laredo Bridge to UP

UP serves six border crossings between the United States and Mexico. However, the Laredo crossing is by far the most important. UP's principal route between the United States and Mexico runs from San Antonio, Texas to the Mexican border at

Laredo. The Laredo crossing provides the most efficient way for U.S. railroads to serve numerous shippers on TFM's system in the industrialized heartland of northeastern and central Mexico. For most movements between the United States and the regions of Mexico served by TFM, the TFM route to Laredo is much more efficient than the route of Ferrocarril Mexicano ("Ferromex"), which connects to the border crossing at Eagle Pass, Texas. (The TFM route to Laredo is also more efficient than TFM's route to the crossing at Brownsville, Texas.) Moreover, the Laredo crossing has an infrastructure that is unmatched. Over the years, numerous brokers have set up major operations in the Laredo area, and U.S. and Mexican government agencies (including customs, immigration officials, and agricultural and narcotics inspectors) have established significant operations there. The three railroads serving this crossing have built extensive yards, holding tracks, and other facilities in the area. In recent years, UP has invested heavily in facilities at Laredo, Port Laredo (10 miles to the north), and other locations further north of Laredo in order to support the import and export traffic that moves over the Laredo Bridge.

In 2002, UP interchanged 382,723 rail cars (both loads and empties) with TFM at the Laredo Bridge, out of 519,882 rail cars that crossed the Bridge in that year. In the past few years, UP's share of the rail cars that moved over the Laredo Bridge has been in the range of 70 to 75 percent. UP's share of loaded rail cars is between 75 and 80 percent. (UP and TFM have agreed to route many empty UP rail cars over the Brownsville crossing to free up more capacity at Laredo. Thus, UP's share of empties moving over the Bridge is lower than its share of loaded cars.) Tex Mex, which also

interchanges with TFM at the Laredo Bridge, accounts for the remainder of the rail cars that cross at Laredo.

The following table shows UP's share of Laredo Bridge crossings (total loaded and empty rail cars) during the years 1998 through 2002:

**Laredo Bridge Crossings
(1998-2002)
(Rail Cars - Loaded and Empty)**

	Northbound			Southbound			Northbound and Southbound		
	UP Cars	Total Cars	UP as % of Total	UP Cars	Total Cars	UP as % of Total	UP Cars	Total Cars	UP as % of Total
1998	114,805	168,044	68%	117,408	176,237	67%	232,213	344,281	67%
1999	133,455	201,414	66%	137,055	204,319	67%	270,510	405,733	67%
2000	145,458	187,045	78%	145,310	208,357	70%	290,768	395,402	74%
2001	166,705	237,837	70%	177,575	248,773	71%	344,280	486,610	71%
2002	185,059	253,525	73%	197,664	266,357	74%	382,723	519,882	74%

Bridge Operations

UP and its customers have a keen interest in preserving efficient and fair operations at Laredo Bridge. If Bridge operations do not remain fluid, or if UP trains do not receive even-handed treatment for movements over the Bridge, service levels for UP customers using the Laredo gateway will decline.

Rail operations over the Laredo Bridge present significant operational challenges. As with any border crossing, extra time is required because of the need for government paperwork and inspections. In addition, the Laredo Bridge has only a single track. Thus, trains can operate in only one direction at a time. In order to obtain as much capacity as possible from the Bridge, trains must be carefully staged so that they are

ready to move as soon as the previous train has moved off the Bridge. Interchanges occur while the train is on the Bridge. Thus, crews of the receiving carrier must be prepared to move quickly onto the Bridge, so that the train does not block the Bridge longer than necessary.

Only one railroad -- TFM -- approaches the Bridge from Mexico, but two railroads -- UP and Tex Mex -- approach from the U.S. side. Thus, it is necessary to coordinate the movement of two railroads moving south onto the Bridge. Northbound movements must also be coordinated carefully, since TFM delivers separate trains or blocks of cars to each U.S. carrier. The railroads must time movements so that the receiving railroad's tracks are clear when a train moves off the Bridge. All three railroads must adhere to strict timelines in order to maintain fluid operations over the Bridge.

In recent years, the three railroads that use the Laredo Bridge have made great strides in improving the efficiency of movements over the Bridge. The railroads have worked with brokers and government agencies to expedite customs clearance, agricultural inspections, and inspections for narcotics and illegal aliens. In addition, the railroads have made extensive infrastructure improvements to increase their ability to stage trains crossing the border in an efficient manner and to minimize interference between northbound and southbound trains in the Laredo area. The railroads have also worked to reduce disruption to the local communities by making changes to minimize the number of grade crossings blocked by waiting trains.

In addition, the railroads have made extensive efforts to improve their operating practices, so that movements across the Bridge are as fluid as possible. One

aspect of these operational improvements involves interchange “windows.” For many years, the railroads have agreed on particular time periods during which trains will move in a single direction, in order to maximize the available capacity on the Bridge. Certain hours of the day are set aside for northbound movements across the Bridge, and other hours are set aside for southbound movements. Before 1994, there were just two 12-hour windows each day. As a result, traffic often backed up on both sides of the border as trains waited for the window to change. In 1994, after a series of meetings, the railroads agreed to change to four six-hour windows, two in each direction. As a result, yard capacity requirements on both sides of the border were cut in half, traffic moved more efficiently to and from the Bridge, and the railroads were able to coordinate their interchanges more effectively.

In recent years, the railroads have worked hard to coordinate the timing of movements over the Bridge. The three railroads now exchange extensive information on their operating arrangements, so that each railroad can position its trains according to a predictable timeline. This allows each railroad to assemble blocks of cars and position trains so they are ready to move onto the Bridge and be interchanged at the time a railroad on the other side of the border is prepared to receive those blocks. Railroad personnel have also agreed on priorities for certain categories of trains (for example, intermodal and automotive) that should cross ahead of others.

In addition, the railroads have pre-blocked cars for each other, allowing some trains to bypass the yards of the receiving carrier in the Laredo area. For example, UP creates blocks of cars destined for Monterrey and Mexico City, allowing TFM to avoid classifying these cars at its Sanchez Yard. Similarly, TFM creates blocks of UP

cars destined for East St. Louis and Chicago, allowing UP to avoid classifying the cars at Port Laredo. This pre-blocking helps keep train operations more fluid on both sides of the border, which makes the Bridge crossing process more efficient.

Despite carefully developed operating plans, many unexpected events occur in the course of each day. Representatives of the railroads that handle trains crossing the Laredo Bridge hold two conference calls each day to discuss such developments. During these calls, held at 9 a.m. and 6 p.m., the railroad representatives exchange up to date information and negotiate about how to resolve competing demands and respond to unexpected events. Railroad employees also speak with the Border Superintendent (a TFM employee, since mid-2001) at other times during the day to provide updates and discuss the progress of interchange activity. The Border Superintendent acts as the traffic cop, making ultimate decisions about which trains will move across the Bridge and the order in which they will proceed.

The many operational improvements the railroads have made over the years, along with infrastructure additions and improvements in government clearance and inspection procedures, have resulted in major improvements in efficiency. In turn, this has permitted very substantial increases in the amount of traffic that moves over the Bridge. I recall that in 1994, when I first became involved with UP's rail operations to and from Mexico, the largest number of cars that moved across the Bridge in one direction in a 24-hour period was in the range of 300 to 400. Today, between 900 and 1,100 cars move in each direction on the highest volume days. Thus, the various improvements that are now in place have essentially tripled the capacity of the Bridge since 1994.

With current government requirements and operating procedures, the Bridge is operating close to capacity now. Even with the impressive efficiency improvements made in recent years, there are times when more traffic builds up at the border than can be moved across the Bridge in a six-hour window. With the forecasted growth in rail traffic between the United States and Mexico, the Bridge will be at or over its capacity within the next few years.

The current Laredo Bridge operations involve a very delicate balance. While some of the operational improvements that have been made are well established and likely to continue in place (for example, expedited customs procedures), other practices that have helped to expedite operations are highly dependent on the good faith cooperation of the personnel of all three railroads. The advance exchange of operating information, discussion of operating problems on daily conference calls among the railroads, cooperative resolution of differences to maximize efficiency, and even-handed decisions about which trains will receive priority are all dependent on the continuation of a strong spirit of cooperation among the parties.

Sequencing of Trains

Decisions about the order in which trains will move across the Bridge are particularly sensitive. Ultimately, one individual (TFM's Border Superintendent) makes the final decisions about train movements. This individual decides, for example, whether to extend a window to permit an additional train to travel southbound before switching to the northbound window. When trains of more than one railroad are waiting to cross southbound, the Border Superintendent decides which train will move onto the Bridge ahead of the others. Thus, the Border Superintendent exercises a substantial amount of

discretion and is in a position to favor one railroad over another if he should choose to do so.

UP believes that in recent years TFM's Border Superintendent has administered Laredo Bridge operations in an even-handed manner. In general, he has avoided showing favoritism to either one of the U.S. railroads. My perception is that the Border Superintendent has generally made crossing decisions in a manner that has permitted UP to move cars across the Bridge in proportion to its overall percentage of Laredo traffic. In other words, if there are more trains waiting than can cross within a southbound window, the Border Superintendent has cleared UP trains to cross first more than half of the time, reflecting UP's higher percentage of the southbound traffic. The same has been true for northbound TFM blocks intended for UP. As a result, for loaded cars, the allocation of slots for Bridge crossings has approximately reflected the market demand for the UP and Tex Mex services. (This is not the case for empty cars. As I noted above, UP has shifted a large number of empty movements to the Brownsville gateway in order to ease the burden at Laredo.)

However, in the past, when the number of trains waiting to cross was greater than the number that could cross during a six-hour window, Tex Mex has argued that its southbound trains, or blocks of cars TFM is sending northbound to Tex Mex, should receive 50 percent of the available slots. In other words, despite the fact that it currently carries far less than 50 percent of the traffic that moves via the Laredo crossing, Tex Mex has requested a one-for-one allocation, so that when there are more UP and Tex Mex trains waiting than can cross during a window, Tex Mex would receive every other slot. Under such an allocation, UP trains would always be the ones that would have to

wait for the next window (even when they had been in position to cross before the last Tex Mex train arrived).

To date, TFM's Border Superintendent has resisted the Tex Mex arguments. He has continued to give Bridge access to UP and Tex Mex trains in a way that reflects approximately the railroads' relative percentages of Laredo traffic.

Effect of Common Control of TFM and Tex Mex on Bridge Operations

I and other UP personnel are concerned that a transaction that brings TFM and Tex Mex under the common control of Kansas City Southern would upset the efficient and even-handed operation that now exists in connection with Laredo Bridge operations. As a result of common control, the economic interests of TFM, Tex Mex, and Kansas City Southern Railway ("KCSR") will be more closely aligned. Under the control of KCS, Tex Mex and TFM will have greater incentives to take subtle, incremental steps that would disadvantage UP and cause its service to deteriorate. For example, a Border Superintendent who favored Tex Mex based on its Nafta Rail affiliation might decide to extend interchange windows to permit Tex Mex trains to move south over the Bridge, while making no such exceptions for UP trains. Eventually, such incremental steps would have the effect of moving traffic from UP-TFM routings to KCSR-Tex Mex-TFM routings, or to Tex Mex-TFM routings that include The Burlington Northern and Santa Fe Railway Company ("BNSF").

In addition, under common control with Tex Mex, TFM will have less incentive to resist the argument that Tex Mex trains should receive access to the Bridge on a one-for-one basis, *i.e.*, at a rate that exceeds Tex Mex's share of Laredo traffic. A Border Superintendent affiliated with Nafta Rail is much more likely to take the position

that Tex Mex trains should have Bridge access 50 percent of the time, even though Tex Mex currently carries only 25 percent of the traffic to and from the Laredo Bridge. Because the Bridge is operating close to capacity now, this sort of allocation of slots would give special preference to KCSR-Tex Mex-TFM and BNSF-Tex Mex-TFM movements while significantly disadvantaging UP-TFM movements. Whenever there are more cars waiting than can move across the Bridge during a window, the delayed cars (*i.e.*, those at the end of the queue) will be UP cars.

For example, if eight UP trains and two Tex Mex trains were waiting, but only six trains could move across the Bridge during a southbound window, under a 50 percent allocation all of Tex Mex's trains would cross, but only half of UP's trains could cross. The remaining four UP trains would have to wait six more hours, until the next southbound window opened. If train volumes continued to exceed the Bridge capacity, UP trains would continue to be delayed through subsequent windows. As a result, the overall efficiency of UP-TFM movements would decrease, while KCSR-Tex Mex-TFM and BNSF-Tex Mex-TFM movements would become more efficient and thus more attractive to shippers. Eventually some of the UP traffic would shift to Tex Mex in order to continue moving via Laredo.

We have already seen signs that TFM's attitude toward UP is changing. In the past, the relationship between UP personnel and TFM personnel has been highly cordial on a personal level. Since KCS announced its proposed transaction, however, TFM personnel have become more distant and more formal in their relations with us. While at least for now we are able to work with TFM's Border Superintendent to resolve Bridge issues, he has been less accessible than previously.

The Need for a Remedy

If the Nafta Rail transaction is approved, it will be important for the Board to take steps to ensure that UP receives fair treatment for its trains at the Laredo Bridge. If TFM and Tex Mex choose to engage in even subtle discrimination against UP trains at the Bridge (which we expect they will, once under common control by KCS), this will reduce the efficiency of UP-TFM routes and disadvantage UP's customers. There would be significant reductions in the efficiency of the UP-TFM routes if TFM were to shift to a 50-50 allocation of Bridge slots. As described above, though on its face even-handed, such a system would have a disproportionate effect on the carrier that has attracted the majority of the traffic (currently UP).

With a one-for-one allocation of Bridge slots, the majority carrier's trains would always be the ones left to wait until the next window when there were too many trains waiting to cross. (And, as noted above, if more trains arrive to fill up the next window, the delays to the majority carrier's trains continue through additional periods.) By reducing the number of UP trains that could cross during a six-hour window, and thereby artificially reducing the efficiency of UP-TFM movements, the Nafta Rail carriers would be able to shift traffic to what would otherwise be a less efficient KCSR-Tex Mex-TFM or BNSF-Tex Mex-TFM route.

Applicants have claimed that UP could avoid any such discrimination by threatening to move traffic to other border crossings. But UP could not simply shift a large volume of trains to other crossings, as Applicants have suggested. As explained above, other crossing points are much less efficient than Laredo. Moreover, there is far less of the necessary infrastructure at Eagle Pass, and thus much less capacity there. Eagle Pass today has less infrastructure than Laredo had 10 years ago. It would take

many years to build up yard facilities, main track, a large broker community, and government services to a point where Eagle Pass could absorb a large amount of UP's Laredo traffic. The Brownsville crossing has even fewer facilities. Moreover, at Brownsville, UP would depend on TFM's cooperation.

UP also could not avoid the effects of discriminatory treatment by constructing a new bridge at Laredo. Construction of a new bridge and related facilities would be quite expensive (probably close to \$100 million) and could not be undertaken without approval from the Mexican government. UP took steps toward construction of a new bridge in the early 1990s, but encountered delays in obtaining approvals from the Mexican government and dropped its plans without having obtained that approval. In my opinion, such approvals would be no easier to obtain today. Moreover, UP operations over a new bridge would still require cooperation from TFM.

Applicants also suggest that the written agreements governing Bridge operations provide UP with sufficient protection. I disagree. A 1951 written agreement between a predecessor of UP and Tex Mex sets out various terms for the joint operations at the Laredo Bridge. Section 4(III) of this agreement provides that "Joint Switching Service" shall be "performed impartially" and that "no preference shall be given to movement of cars of one of the parties." (Exhibit B to this statement shows the relevant provision of the 1951 agreement.) However, the agreement does not specify what this means, how it applies in the context of today's operations (which differ from those described in the 1951 agreement in various ways; for example, the parties no longer perform switching services for each other), or how it is to be accomplished. The agreement does not foreclose Tex Mex's argument that "no preference" means a 50/50

allocation, even when the traffic percentages are not 50/50. I do not believe the 1951 agreement or any of its amendments would be sufficient to ensure even-handed treatment for UP trains once TFM and Tex Mex are under common control.

I am aware that Applicants have stated that they will continue to cooperate with UP regarding utilization of the Laredo Bridge and that they will honor existing agreements governing operations over the Bridge. We welcome these statements. However, Applicants' assurances to date have been stated in very general terms. In order to ensure that all parties receive fair treatment in Bridge operations, there is a need for more clearly defined commitments that would be enforceable. In a letter dated July 21, 2003, counsel for KCS has said it is willing to commit to negotiate in good faith to develop new dispatching protocols for the Bridge and to have this be a condition of its common control of Tex Mex. We believe this is a sensible approach to the Bridge issue. But in order to ensure that all railroads do in fact receive fair treatment, we believe the Board, in imposing such a condition, should set out more specific guidance to the parties and retain jurisdiction to impose an appropriate arrangement if the parties cannot arrive at a consensus solution.

What the Board Should Do

To help ensure that all parties will receive even-handed treatment in connection with operation of the Bridge, the Board should require the parties to adopt new Bridge protocols that adhere to the following principles (unless the parties agree that appropriate protections can be achieved in other ways).

First, UP's role in Bridge operations should be formalized through establishment of a joint operations center responsible for Bridge operations. As

described above, UP personnel currently participate in regular exchanges of operating information and daily conference calls relating to Bridge operations, and UP has had the opportunity to communicate freely with TFM personnel responsible for decisions on Bridge crossing sequence. If the Nafta Rail transaction goes forward, there is a real danger that UP will be shut out of the decisionmaking process and that TFM employees will make unilateral decisions that favor TFM-Tex Mex movements over TFM-UP movements. Prior to mid-2001, when Tex Mex controlled movements over the Bridge, UP faced difficulty in communicating with Tex Mex and having its input considered in management of the Bridge crossing operation. Communication and coordination improved greatly after TFM took control of the Bridge operation. However, UP's perception is that TFM and Tex Mex both regard the Bridge as their "franchise." We believe that, under common control, TFM and Tex Mex will reduce the level of communication and coordination we have seen in recent years and deny UP an influential role in management of the Bridge crossing operation.

The best way to ensure that all three railroads, including UP, continue to have input into decisions about Bridge operations and about whose trains should receive priority when the number of trains waiting exceeds the capacity of a Bridge window is to establish a joint operations center that will control the flow of traffic across the Laredo Bridge. This center should dispatch trackage that extends from UP's Port Laredo Yard to Tex Mex's Serrano Yard, across the Bridge, to TFM's Sanchez Yard.

Joint operations centers are used to coordinate operations when more than one railroad uses the same track and to ensure that all railroads are treated in a neutral manner. In such centers, employees of all railroads sit together in the same dispatching

facility and play a role in the dispatching operation. Dispatchers at a joint operations center have an obligation to act in a neutral manner toward the trains of all participating railroads. The railroads generally agree to structure incentives of these employees to reward the efficient movement of all trains, not just the trains of a particular carrier.

Joint dispatching operations have worked well for trackage in a number of locations, including the Houston area, the Powder River Basin in Wyoming, San Bernadino, California, Kansas City, and the Chicago area. For example, the Spring Dispatching Center in Houston, which is responsible for joint dispatching of jointly owned lines in Houston and between Houston and New Orleans, has been very effective. BNSF, which shares with UP in the joint dispatching, has praised the Spring Center for promoting both efficiency and fairness. (KCS and Tex Mex have been invited to join, but have declined.) Including as part of the condition a requirement that the Nafta Rail carriers and UP negotiate to establish a joint operations center for Bridge movements should not pose a burden. If anything, it should make coordination easier and more effective.

The Board would not need to prescribe the details of a joint operation. Railroads have successfully negotiated these arrangements in the past. At this point, the Board should simply establish the general principle of a joint operations center and allow the parties to work out the operational details.

Second, Applicants should accept an express obligation to manage Bridge operations in a manner that is non-discriminatory and that will achieve maximum efficiency in operation of the Bridge. UP would subscribe to such a commitment. Such an arrangement would allow each carrier to invoke a formal commitment that the others

will continue to participate in practices that maximize the total capacity and operating efficiency of the Bridge, rather than favoring any one user.

Third, the protocols should make clear that, at any given time, Bridge capacity will be allocated in proportion to each railroad's share of traffic at the Laredo crossing. As explained above, UP is concerned that the Nafta Rail carriers will impose a 50-50 allocation of available Bridge slots. Such a one-for-one protocol would guarantee superior treatment for the carrier with less traffic (currently Tex Mex), which would receive half of the slots. When there are more trains waiting than can be accommodated during a window, the carrier that enjoys greater market demand for its services (currently UP) would always be the one that lost the opportunity to cross some of its trains during that window.

Under a fair allocation, when multiple trains are waiting to cross the Bridge in one direction, each railroad should receive slots that would permit it to use the Bridge in accordance with its percentage of the rail traffic that moves via Laredo. Of course, there should be some flexibility in applying a percentage-based formula. It would not be appropriate for the railroads to follow this formula rigidly on a daily basis if doing so would substantially reduce the number of cars moving over the Bridge during a particular day. There should be exceptions for expedited trains (for example, intermodal trains) that need special priority. Moreover, if a railroad could not use all of its allocation, the unused time should be available for the other railroad.

Again, it should not be necessary for the Board to prescribe all of the details of a slot allocation process. Rather, the Board should simply require the parties to negotiate an agreement that would provide slots in proportion to the amount of each

carrier's Laredo traffic. The parties should be able to work out details, such as how to divide capacity into slots. If the parties could not reach agreement, the Board could fashion an appropriate protocol with input from the parties. However, the parties themselves are in the best position to determine how such a system could be implemented, and I believe they will be able to reach agreement following negotiations.

II. TEX MEX TRACKAGE RIGHTS OPERATIONS

I have reviewed certain allegations the Applicants have made in their filings concerning Tex Mex operations over UP track. Applicants claim that UP has a "chokehold" on Tex Mex and could interfere with Tex Mex movements to and from Laredo if it wished to do so. (I assume Applicants are referring to Tex Mex's operations over UP's track between Beaumont, Texas and Robstown/Corpus Christi, Texas, under trackage rights Tex Mex obtained in connection with the Board's 1996 approval of the UP/SP merger.) However, UP has not interfered with Tex Mex operations in the past; moreover, we would not and could not take any such action in the future. The Tex Mex trackage rights operations are subject to extensive protections to ensure that UP does not discriminate against Tex Mex's trains. Ultimately, the trackage rights operations are subject to Board oversight.

The UP-Tex Mex Dispatching Protocol

The Tex Mex trackage rights are governed by a detailed dispatching protocol, negotiated by UP and Tex Mex personnel in 1996 in connection with the Board's award of the trackage rights. A copy of this protocol is attached as Exhibit C to this statement. Under the terms of the protocol, there are numerous specific requirements for administration of the trackage rights.

Under Section 3 of the dispatching protocol, UP dispatchers in this territory must be instructed to treat all trains equally, whether they are UP or Tex Mex trains. Under Section 12 of the protocol, in evaluating performance of its dispatchers, UP must consider performance of Tex Mex trains and effectiveness of meeting Tex Mex service requirements. Under Section 13 of the protocol, Tex Mex has the right to request a meeting with UP personnel to discuss any disagreement about compliance with the protocol and to present such disagreements to a Joint Service Committee comprised of the chief transportation officers of UP and Tex Mex. Tex Mex may submit a disagreement to binding arbitration before a neutral official if it is not satisfied with the Joint Service Committee's action.

I am not aware of a single instance in which UP has violated the protocol governing movement of Tex Mex trains on UP track or otherwise taken action to disadvantage these Tex Mex trains vis-à-vis UP trains. From time to time, various operational problems common to all railroads have contributed to slow velocities on portions of the UP track Tex Mex uses. However, these problems have not been specific to Tex Mex. Rather, they have slowed the movement of all trains (including UP trains) using the tracks.

Tex Mex Delay Claims

Tex Mex has raised concerns about delays its trains have experienced while using UP's tracks. Tex Mex reports that, in a number of cases, the hours of service of a Tex Mex train crew have expired before the train reaches a crew change point, and Tex Mex has had to recrew the train. Earlier this year Tex Mex requested a meeting of the Joint Service Committee established under the UP-Tex Mex dispatching protocol in

order to discuss its concerns about this situation. This was the first time Tex Mex had ever requested such a meeting. In March 2003, I and one of my staff met with Jerry Heavin, Senior Vice President of Operations for KCSR, to review the Tex Mex concerns. We had a productive session in which we discussed these concerns. I advised Mr. Heavin that the velocities of two Tex Mex trains (AJAMXJ and AMXJAX) had improved over the preceding four months. We agreed on steps to follow up on various issues, as well as weekly meetings between UP and Tex Mex personnel for the future. During the March 2003 meeting Mr. Heavin did not identify any respect in which Tex Mex or KCS believed that UP had violated the protocol.

Since the March meeting, UP and Tex Mex personnel have held meetings each Friday to review any concerns about operation of the Tex Mex trains over UP track. In each case in which Tex Mex identified a train delay, UP personnel investigated and explained the relevant circumstances to Tex Mex personnel. Together the UP and Tex Mex personnel identified factors that appear to have been responsible for any delays to the Tex Mex trains. After reviewing the information provided to them, Tex Mex personnel have not identified any UP violation of the protocol.

In my view and that of others at UP, one major factor that causes many Tex Mex crews to expire due to hours of service regulations during movements over the trackage rights is the fact that the Tex Mex crew districts are quite long, much longer than UP's crew districts in the same corridor. Between Houston and Laredo, Tex Mex has just two crew districts -- between Houston and Victoria (216 miles) and between Victoria and Laredo (242 miles). In contrast, most of UP's crew districts in this corridor are between 50 miles and 160 miles in length, and none is as long as the Tex Mex

districts. With such long crew districts, it is not surprising to me that Tex Mex crews frequently expire due to hours of service regulations.

In fact, I believe that the UP dispatchers probably give Tex Mex trains better treatment than UP trains as a result of this situation. UP's dispatchers generally attempt to give priority to a train when the crew is about to expire due to hours of service regulations (in order to allow the train to reach a terminal, rather than tying up mainline capacity). Because of the length of the Tex Mex crew districts, Tex Mex crews are often in danger of exceeding their hours of service. Due to UP's shorter crew districts, UP crews are less likely to be in this situation and thus the UP trains are less likely to receive priority.

Operating statistics UP has collected confirm that Tex Mex trains are suffering fewer delays than UP trains in this part of Texas. In November 2002, the Spring Dispatching Center conducted a four-day study of trains operating on UP's Angleton and Brownsville Subdivisions, parts of which are used by Tex Mex trains operating via trackage rights. This study showed that on average, as among UP, BNSF, and Tex Mex trains, UP trains suffered the most minutes of delay for each train, while Tex Mex trains experienced the fewest minutes of delay per train. Exhibit D to this statement shows the data on minutes of delay per train for UP, BNSF, and Tex Mex trains from the November 2002 study.

There is no reason to believe that UP would choose to discriminate against Tex Mex in connection with these trackage rights in the future. UP uses all of the trackage rights lines for its own trains. Any actions UP took to delay Tex Mex trains would increase congestion on the lines, and this would result in delay to UP trains as

well. In addition to this natural check on any discriminatory conduct, Tex Mex can control UP's conduct by enforcing Tex Mex's rights under the protocol. Tex Mex can monitor performance of its trains, raise its concerns with UP, and seek a binding arbitration award if it cannot obtain a satisfactory resolution through discussions with UP. If it believes the trackage rights are not operating in the manner the STB intended, Tex Mex could seek relief from the Board.

The Board should note that Tex Mex has had opportunities to participate more fully in oversight of the operations on the trackage rights lines, but it has failed to take full advantage of these opportunities. As noted above, under the protocol, Tex Mex has the right to request a Joint Service Committee meeting any time there is a disagreement about compliance with the protocol. As also noted above, Tex Mex has requested only one meeting since it began use of the trackage rights in 1997. Moreover, Tex Mex has never sought binding arbitration of a claim that UP has violated the protocol, although it is entitled to do so under the terms of the protocol.

In addition, Tex Mex is free to participate in the Spring Dispatching Center, the joint operations center UP and BNSF operate at Spring, Texas. If Tex Mex agreed to participate in the Spring joint operation, it could have a managerial employee sitting in the same room as the UP and BNSF dispatchers who control train movements on the trackage rights lines. This would facilitate communications and coordination of the Tex Mex train movements over the trackage rights. Despite previous invitations, Tex Mex has declined to participate at Spring. UP and BNSF continue to welcome Tex Mex as a participant in the Spring joint operation.

Capacity Issues

Applicants have also suggested that there is insufficient capacity on the trackage rights lines Tex Mex uses. UP's Network Planning Department, which prepares analyses of line capacity, regularly studies line capacity related to traffic volumes. Based on these analyses, UP has found that there is more than enough capacity to accommodate actual traffic volumes on most of the lines Tex Mex uses. For a portion of the Brownsville Subdivision, Network Planning has concluded that there is sufficient capacity to carry current traffic volumes, although traffic would exceed capacity if several trains per day were added. However, there is enough capacity that Tex Mex could add new traffic to this line without additional investment. Network Planning's analyses also indicate that the trackage rights lines Tex Mex uses are considerably less constrained than the line between San Antonio and Laredo used by UP's trains, where traffic volumes exceed capacity by several trains per day.

Applicants have asserted that UP failed to meet commitments to expand the capacity of the trackage rights lines. In fact, since UP and Tex Mex entered into the trackage rights agreement, UP has spent many millions of dollars on capital projects that benefit lines that Tex Mex uses. If Tex Mex believes that UP has violated that agreement or some other contract by failing to make certain capital investments, it could raise this claim. However, Tex Mex has never informed UP of a capital improvement it believes should have been made on the trackage rights lines.

If it believes its operations on UP's tracks are limited by a lack of capacity, Tex Mex could take at least two steps to help alleviate the situation. First, Section 5 of the 1996 trackage rights agreement gives Tex Mex the right to identify and fund construction of sidings and other capital improvements on the trackage rights lines,

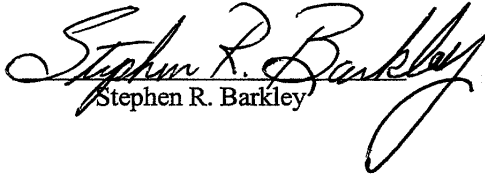
without UP having any veto. Tex Mex has never invoked this provision in the period since it began using the trackage rights, but this continues to be an available option. Second, UP has sold to Tex Mex the old SP Wharton line, which runs between Victoria and Rosenberg. Tex Mex could proceed with plans to rehabilitate this line and use this shorter route in place of approximately 100 miles of trackage rights on UP. This would shorten Tex Mex's route from Houston to Laredo and eliminate any concern about capacity on one portion of the UP lines.

* * *

In summary, there is no realistic prospect that UP could impose a "chokehold" on Tex Mex operations to and from Laredo. UP has not interfered with Tex Mex's operations in the past, and we have no intention of doing so in the future. In any event, Tex Mex can take effective steps to obtain relief if it believes UP is discriminating against Tex Mex trains or otherwise acting in violation of the 1996 dispatching protocol. In addition, Tex Mex has the right to fund capacity additions to the lines it uses. These protections are far more effective than any rights UP could invoke today in connection with the Laredo Bridge operations.

I, Stephen R. Barkley, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on August 1, 2003.


Stephen R. Barkley

EXHIBITS

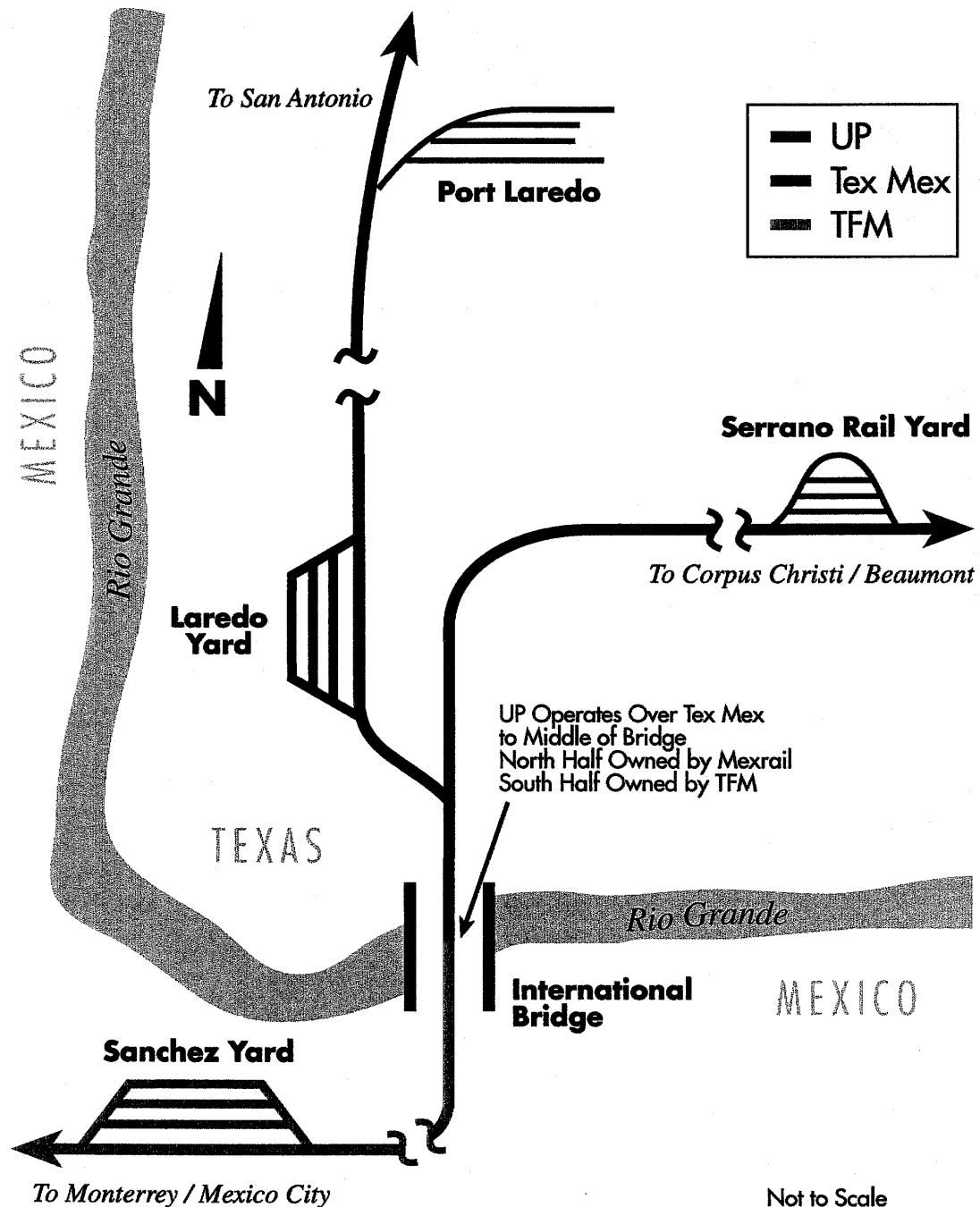
Exhibit A - Laredo and the International Bridge

Exhibit B - 1951 Agreement (excerpt)

Exhibit C - UP-Tex Mex Trackage Rights Terms (including dispatching protocol)

Exhibit D - Average Train Delay (Angleton and Brownsville Subdivisions)

Laredo and the International Bridge



B

AGREEMENT

between

**GUY A. THOMPSON, Trustee,
INTERNATIONAL GREAT NORTHERN
RAILROAD COMPANY, DEBTOR,
(Herein Called International Trustee)**

and

**THE TEXAS MEXICAN RAILWAY COMPANY
(Herein Called Tex-Mex Company)**

Covering, among other things, the use of certain tracks, improvements and motive power of each International Trustee and Tex-Mex Company, and the performance by certain employees of International Trustee and Tex-Mex Company of certain switching, terminal and other services, incident to the interchange of passenger train cars, and any passengers, baggage, mail and express contained therein, and of freight train cars, and any freight contained therein, between the National Railways of Mexico and each the International Trustee and the Tex-Mex Company at the U. S.-Mexican Boundary Line.

Laredo, Texas.

JAN-18172

(III) Joint Switching Service shall be performed impartially for the account of the parties hereto; and no preference shall be given to movement of cars of one of the parties hereto over cars of the other party hereto.

(IV) Movement of International Trustee's passenger train cars shall have precedence over the movement of freight train cars over Tex-Mex Green Tracks at all times. Subject to foregoing, Joint Switching Service shall have preference over all other movements on Tex-Mex Green Tracks except that Tex-Mex Company shall have preference in the use of Tex-Mex Green Tracks by Tex-Mex Company's sole engine and crew performing sole switching service for Tex-Mex Company on Tex-Mex Company's tracks now or hereafter located near and just easterly of Tex-Mex Green Track No. 1 and intermediate Ventura Street and Lincoln Street, the Tex-Mex Company hereby agreeing to so perform its sole switching service as to not unnecessarily or unreasonably interfere with the movement over Tex-Mex Green Tracks in Joint Switching Service of freight train cars.

Section 5. Persons Employed In Performing Services Hereunder.

(A) Each party shall have the right, at such party's sole expense and with such party's sole employes, to handle all papers required by the United States and Mexican governmental authorities for the movement of export and import cars of such party; and shall cause such party's said sole employes to cooperate with the supervisory officer and yard clerks hereinafter referred to in expediting the movement of said export and import cars. Not more than one such sole employe of each party shall be stationed at the Yard Office at the International Bridge at any one time for the purpose aforesaid; and said sole employe may examine only records pertaining to his employer's business.

C

TERMS FOR TEXAS MEXICAN RAILWAY COMPANY
TRACKAGE RIGHTS

The following terms (hereinafter referred to as the "Terms") shall govern rights provided by MISSOURI PACIFIC RAILROAD COMPANY, a Delaware corporation ("MP"), and SOUTHERN PACIFIC TRANSPORTATION COMPANY, a Delaware corporation ("SP"), with MP and SP jointly and severally referred to as "MP/SP" or "Owner," on the one hand, to THE TEXAS MEXICAN RAILWAY COMPANY ("Tex Mex" or "User"), on the other hand, with MP/SP and Tex Mex sometimes referred to collectively as "Parties," pursuant to the decision of the Surface Transportation Board ("STB") in Finance Docket No. 32760 served August 12, 1996 (the "Decision").

RECITALS

A. MP/SP owns lines of railroad consisting of track structure extending between Robstown, Texas and Odem, Texas, and between Corpus Christi, Texas, and Beaumont, Texas, by way of Odem, Texas, identified as follows:

MP's line between Robstown, Texas, in the vicinity of MP Milepost 141.48 and Placedo, Texas, in the vicinity of MP Milepost 224.2;

MP's line between Corpus Christi, Texas, in the vicinity of MP Milepost 145.59, and Odem, Texas, in the vicinity of MP Milepost 132.2, via Savage Lane to MP's Viola Yard;

SP's line between Placedo, Texas, in the vicinity of SP Milepost 14.2, and West Junction, Texas, in the vicinity of SP Milepost 12.6, via Victoria, Texas, and Flatonia, Texas;

SP's line between West Junction, Texas, in the vicinity of SP Milepost 12.6, and T&NO Junction, Texas, in the vicinity of SP Milepost 4.6;

SP's line from West Junction through Bellaire Junction to Chaney Junction, in the vicinity of SP Milepost 2.8;

SP's line from Chaney Junction, in the vicinity of SP Milepost 2.8, to Tower 26, in the vicinity of SP Milepost 360.7, via the Houston Passenger station;

SP's line from Chaney Junction, in the vicinity of SP Milepost 2.8, to Tower 26, in the vicinity of SP Milepost 360.7, via the Hardy Street yard;

MP's line from Settegast Junction, in the vicinity of MP Milepost 381.61, to the connection with HB&T at Interstate Junction, in the vicinity of MP Milepost 7.60;

SP's line from T&NO Junction, in the vicinity of SP Milepost 4.6, to the connection with PTRR, in the vicinity of Katy Neck (GH&H Junction), in the vicinity of SP Milepost 1.3;

SP's line from SP Milepost 360.7 near Tower 26 to the connection with HB&T at Quitman Street, in the vicinity of SP Milepost 1.45;

MP's line between Gulf Coast Junction, Texas, in the vicinity of MP Milepost 377.98, and Amelia, Texas, in the vicinity of MP Milepost 451.4;

MP's line between Amelia, Texas, in the vicinity of MP Milepost 451.4, and the connection with SP at Langham Road, Texas, in the vicinity of MP Milepost 456.7;

SP's line between Langham Road, Texas, in the vicinity of MP Milepost 456.7, and Tower 74, in the vicinity of MP Milepost 458.8;

MP's line between Tower 74, in the vicinity of MP Milepost 458.8, and (1) the connection with The Kansas City Southern Railway Company ("KCS") at GLC Jct., Texas, in the vicinity of MP Milepost 460.36 (KCS Milepost 766.7), and (2) the connection with KCS at the Neches River Draw Bridge in Beaumont, Texas, in the vicinity of KCS Milepost 766.0;

as shown by bold line on the attached prints dated September 23, 1996 (and identified as Exhibit "A") and further described in Section 1.7 of Exhibit "B," which shall be referred to herein as the "Joint Trackage."

B. The STB in Finance Docket No. 32760 approved the common control and merger of the rail carriers controlled by Union Pacific Corporation ("UPC"), including MP and Union Pacific Railroad Company ("UPRR") (UPC, UPRR and MP are referred to collectively as "UP"), and the rail carriers controlled by Southern Pacific Rail Corporation ("SPR"), including SP, conditioned on, among other things, partial grant of the Responsive Application of Tex Mex, dated March 29, 1996.

C. In order to exercise its authority to acquire control of SPR as granted by the STB in Finance Docket No. 32760, MP/SP is willing to provide Tex Mex with the rights specified in the Decision.

D. Tex Mex desires to receive said rights and desires to conduct operations over said rights. Tex Mex and MP/SP now wish to assist the STB in specifically defining the terms and conditions under which said rights shall be exercised.

E. It is the position of Tex Mex and MP/SP that these Terms do not constitute the acquiescence by either of them in the Decision and shall not preclude either of them from seeking any reopening, reconsideration or judicial review of the Decision.

TERMS

1. General Conditions:

The General Conditions set forth in Exhibit "B" attached hereto are hereby made a part of these Terms. All capitalized Terms used and not otherwise defined in these Terms shall have the meaning ascribed to them in the General Conditions. If any conflict between the General Conditions and these Terms shall arise, the provisions of these Terms shall prevail.

2. Rights of Tex Mex:

(a) Subject to the terms and conditions contained herein, MP/SP shall grant to Tex Mex the nonexclusive right to use the Joint Trackage for the limited operation of Equipment in Tex Mex's account over the Joint Trackage in common with MP/SP and such other railroad company or companies as MP/SP has heretofore admitted or may hereafter at any time in the future admit to the joint use of all or part of the Joint Trackage (provided that such future admittance shall not materially hinder or obstruct the fair and reasonable exercise of the rights granted in these Terms), such other railroad company or companies to be considered MP/SP for the purposes of these Terms, it being understood and agreed that Tex Mex shall not have the right to:

- (i) Switch industries upon the Joint Trackage, except as otherwise provided in Section 2(g);
- (ii) Set out, pick up or store Equipment upon the Joint Trackage, or any part thereof, except as otherwise provided in Sections 2.11, 2.12 and 2.13 of Exhibit B;
- (iii) Serve any industry, team or house track, intermodal or auto facility now existing or hereafter located along the Joint Trackage, except as otherwise provided in Section 2(g);

- (iv) Permit or admit any third party to the use of all or any portion of the Joint Trackage, nor, under the guise of doing its own business, contract or make any agreement to handle as its own Equipment over or upon the Joint Trackage, or any portion thereof, the Equipment of any such third party which in the normal course of business would not be considered the Equipment of Tex Mex; provided, however, that the foregoing shall not prevent Tex Mex, pursuant to a run-through agreement with any railroad, from using the locomotives and cabooses of another railroad as its own under these terms;
- (v) Connect with or interchange with any other railroad, except as otherwise provided in Section 4; or
- (vi) Establish any transload facilities on the Joint Trackage or build into or out from any facility from/to the Joint Trackage.

(b) The rights granted in Section 2 shall be only for rail traffic of all kinds and commodities, both carload and intermodal, in Equipment that meets all applicable specifications established by the Association of American Railroads and the Federal Railroad Administration, provided that all freight handled by Tex Mex pursuant to such rights must have a prior or subsequent movement on Tex Mex's Laredo-Robstown-Corpus Christi Line.

(c) User shall have the right to establish crew change points at points on the Joint Trackage as from time to time may be mutually agreed to in writing by Owner and User. However, User agrees that if sufficient trackage is not available at such location(s) to facilitate crew changes of User, Owner may require User to construct additional trackage ("Crew Change Facilities") in the vicinity of such location as may be required, in the reasonable judgment of Owner, the cost and expense of which shall be borne solely by User. If User does not agree that such Crew Change Facilities are necessary, the Owner may nevertheless insist that they be constructed, with the question of their necessity, and the User's obligation to bear their cost and expense, to be determined by arbitration pursuant to Section 6 of the General Conditions. In the event such Crew Change Facilities are constructed at the cost and expense of User, and Owner shall choose to use such Crew Change Facilities, Owner shall pay User fifty percent (50%) of the cost of constructing such Crew Change Facilities. Should Owner decline to participate, Owner shall be denied access to such Crew Change Facilities. However, should Owner elect at a later date to use such Crew Change Facilities, such right shall be granted to Owner by User upon payment of fifty percent (50%) of User's initial costs plus per annum interest thereon at a rate equal to the average paid on 90-day Treasury Bills of the United States Government as of the date of completion until the date of use by User commences. Per annum interest shall be adjusted annually on the first day of the twelfth (12th) month following the date of completion and every year thereafter on such date, based on the percentage increase or decrease, in the average yield of 30-year U.S. Treasury Notes for the prior year compared to their average yield in first year of completion of the Improvements. Each annual adjustment shall be subject, however, to a "cap" (up or down) of two percentage points of the prior year's

interest rate (i.e. the adjustment may not exceed an amount equal to two percentage points of the immediately preceding year's interest rate).

In addition, Owner shall lease to User, by separate written agreement at reasonable and customary charges, existing facilities for office, locker, change and lunchroom purposes by User's personnel upon request of User to Owner, and as reasonably available, or property of Owner as reasonably available for User to establish its own facilities.

(d) User agrees that when entering or exiting the Joint Trackage or using the Joint Trackage to set out or pick up ("User's Operations"), it shall do so without unreasonable interference or impairment of the Joint Trackage. However, User agrees that if sufficient trackage is not available at such location(s) to facilitate User's Operations, Owner may require User to construct additional trackage in the vicinity of such location(s) as may be required, in the reasonable judgment of Owner, the cost and expense of which shall be borne solely by User. If User does not agree that such additional trackage is necessary, the Owner may nevertheless insist that it be constructed, with the question of its necessity, and the User's obligation to bear its cost and expense, to be determined by arbitration pursuant to Section 6 of the General Conditions. In the event such trackage is constructed at the cost and expense of User, and Owner shall choose to use such trackage, Owner shall pay User fifty percent (50%) of the cost of constructing such trackage plus interest as calculated pursuant to Section 2(c) above.

(e) User shall have the right to such use of SP's Glidden Yard at Glidden, Texas, as is reasonably necessary to effectuate the rights granted by these Terms and on such terms and conditions (including reasonable compensation terms) as may be agreed to in writing by the parties or determined by arbitration pursuant to Section 6 of the General Conditions if the parties fail to agree; provided, however, that such use by User shall not unreasonably interfere with Owner's operations. Any dispute between User and Owner regarding the reasonableness of User's use of Glidden Yard shall be submitted to arbitration pursuant to Section 6 of the General Conditions.

(f) If Owner implements a directional flow of operations between Houston, Texas, and Beaumont, Texas, Owner will assure that User's operations are not adversely affected thereby.

(g) User shall have the right to serve all shippers that, as of September 10, 1996, were capable of receiving service from both MP and SP and no other railroad, directly or through reciprocal switching.

3. GTM Rate:

(a) In addition to other payments to be made under these Terms, User shall remit to Owner monthly for the use of the Joint Trackage in the operation of its Equipment therealong and thereafter, the total amount of 3.84 mills per GTM for all Equipment, which sum per GTM ("GTM Rate") shall be deemed to include ordinary and programmed maintenance of the Joint

Trackage, Changes in and/or Additions to the Joint Trackage (to the extent required by the first sentence of Section 2.2 of the General Conditions), operating expenses, interest rental, depreciation and taxes.

(b) For the purpose of computing the GTM Rate under this Section 3, the distance between the designated points of the Joint Trackage shall be determined by reference to MPRR's EPMS Engineering Mileage Master or SP's Station Pair Master File, whichever is applicable, both of which shall be subject to verification by User.

(c) The GTM Rate set forth in Section 3(a) of these Terms shall be subject to adjustment annually, commencing as of July 1, 1997, as follows:

All trackage rights charges under this Section 3 shall be subject to adjustment annually beginning as of the effective date of these Terms to reflect seventy percent (70%) of increases or decreases in Rail Cost Adjustment Factor, not adjusted for changes in productivity ("RCAF-U") published by the ICC or successor agency or other organizations. In the event the RCAF-U is no longer maintained, the parties shall select a substantially similar index and failing to agree on such an index, the matter shall be referred to binding arbitration.

4. Interchange:

In exercising the rights granted by these Terms, Tex Mex shall have the right to interchange traffic (a) with carriers other than MP/SP at the existing interchange points with those carriers on the Joint Trackage, i.e., (i) at Houston, Texas, with the Port Terminal Railroad Association ("PTRA"), the Houston Belt Terminal Railway Company ("HBT"), The Atchison, Topeka & Santa Fe Railway Company ("ATSF") and Burlington Northern Railroad Company ("BN") (ATSF and BN are referred to collectively as "BNSF"), and (ii) at Beaumont, Texas, with BNSF and The Kansas City Southern Railway Company ("KCS"); (b) with BNSF at Robstown and Corpus Christi and at any new interchange point on the Joint Trackage that may hereafter be established between MP/SP and BNSF; and (c) with MP/SP at Houston, Beaumont and such other points as may mutually be agreed. Any interchange between Tex Mex and PTRA or between Tex Mex and HBT at Houston, Texas, shall be governed by agreements entered into between those parties or terms imposed by the STB.

5. Additions:

(a) Owner and User shall conduct a joint inspection to determine what connections ("Connections") and sidings or siding extensions associated with Connections ("Sidings") are necessary in the reasonable judgment of Owner to implement the rights granted under Section 2 of these Terms. User, at its sole cost and expense, shall pay the cost of such Connections and Sidings. If User does not agree that such Connections and Sidings (other than those described in subsections (i) and (ii), the necessity for which is not in dispute, and to which this sentence does not apply) are necessary, Owner may nevertheless insist that they be constructed, with the question of their necessity, and the User's obligation to bear their cost and expense, to be

determined by arbitration pursuant to Section 6 of the General Conditions. In the event that the User bears the sole cost and expense of any such Connections and Sidings, no other railroad shall have the right to use them except upon terms agreed to by User and such other railroad. In the event Owner shall elect to use such Connections and Sidings, Owner shall pay to User fifty percent (50%) of the cost to User of constructing the Connections and Sidings, plus interest as calculated pursuant to Section 2(c) above, and, having made such payment, Owner may also admit other railroads to the use of such Connections and Sidings. Owner shall maintain the part of any Connection or Siding on its property at its sole cost and expense, and User, at its sole cost and expense, shall maintain the part of any Connection or Siding on its property or property of others. Such necessary Connections and Sidings shall include, but are not necessarily limited to, those described in subsections (i) and (ii) below:

- (i) User shall construct a connection to access MP at Robstown, Texas, to include track 8500 feet in length to permit Tex Mex trains to clear the MP main line (the "Robstown Connection"). The design for the Robstown Connection shall be submitted to Owner for its written approval within forty-five (45) days following the effective date of these Terms, which approval shall not be unreasonably withheld, and User's operation thereover shall be subject to Owner's prior written acceptance of the Robstown Connection. User agrees that the Robstown Connection shall be constructed within one hundred eighty (180) days of acquisition of the required property and approval by Owner of its design. Owner grants User the right to use, as daily dispatching conditions reasonably permit, the existing connection between Tex Mex and Owner at Robstown and 8500 feet of Owner's main line south of that connection, for a period of six (6) months following the date of Owner's approval of the design of the Robstown Connection, which connection and trackage shall be deemed part of the Joint Trackage during the period of Tex Mex's usage thereof, including any extensions of the period as provided below. Owner will extend the period of User's use of the existing connection for an additional six (6) months in the event (a) User is unable to complete the Robstown Connection within the time frame specified in the preceding sentence and User is making a bona fide effort to complete the construction of the new connection, and (b) User's continued operations over the existing connection will not, in Owner's judgment, unreasonably interfere with Owner's operations. If BNSF constructs the Robstown Connection, Tex Mex shall have the right to use the Robstown Connection on terms agreed to by Tex Mex and BNSF. If the Robstown Connection is not constructed by BNSF, Tex Mex shall construct the Robstown Connection as provided above.
- (ii) User shall also construct a connection to access SP at Flatonia, Texas, to include track parallel to SP's Victoria Subdivision, Port LaVaca Branch, 8500 feet in length to permit Tex Mex trains to clear the SP main line (the "Flatonia Connection"). The design for the Flatonia Connection shall be submitted to Owner for its written approval within forty-five (45) days following the effective date of these Terms, which approval shall not be unreasonably withheld, and

User's operation thereover shall be subject to Owner's prior written acceptance of the Flatonia Connection. User agrees that the Flatonia Connection shall be constructed within one hundred eighty (180) days of acquisition of the required property and approval by Owner of its design. Owner grants User the right to use the existing connection between SP's Victoria Subdivision, Port LaVaca Branch, and SP's Glidden Subdivision at Flatonia and siding south of Owner's main line West of that connection for a period of six (6) months following the date of Owner's approval of the design of the Flatonia Connection, which existing connection and trackage shall be deemed part of the Joint Trackage during the period of Tex Mex's usage thereof.

(b) Except as provided in Section 5(a) above, expenditures for any future Changes in and/or Additions to the Joint Trackage, such as, but not limited to, sidings, Centralized Traffic Control, grade separations, and future connections, shall be handled as follows: (i) if the Change in and/or Addition to the Joint Trackage is for the sole benefit of one party, that party shall be solely responsible for the entire cost and expense thereof; (ii) all other Changes in and/or Additions to the Joint Trackage shall be shared by MP/SP and Tex Mex on the basis that the parties' respective GTM's operated over the Joint Trackage bear to total GTM's operated over the Joint Trackage for the twelve (12) month period immediately prior to the month work on the project is commenced. The use of Joint Trackage by any third party shall be attributed to MP/SP for purposes of computing respective GTM's for purposes of this Section 5(b).

(c) In the event such Changes in and/or Additions to the Joint Trackage are constructed at the sole cost and expense of one party (party of the first part), the other party (party of the second part) shall be denied access to such Change in and/or Addition to the Joint Trackage. If the party of the second part at some future date shall choose to use such Changes in and/or Additions to the Joint Trackage, such right shall be granted to party of the second part by party of the first part upon payment of fifty percent (50%) of party of the first part's initial costs plus per annum interest calculated pursuant to Section 2(c).

6. Notices:

All notices, demands, requests, submissions and other communications which are required or permitted to be given pursuant to these Terms shall be given by either party to the other in writing and shall be deemed properly served if delivered by hand, or mailed by overnight courier or by registered or certified mail, return receipt requested, with postage prepaid, to such other party at the address listed below:

If intended for MP/SP:

Executive Vice President-Operation
Room 1206
1416 Dodge Street
Omaha, Nebraska 68179

With a copy to:

Director Joint Facilities
Room 1200
1416 Dodge Street
Omaha, Nebraska 68179

If intended for Tex Mex:

The Texas Mexican Railway Company
1200 Washington Street
P.O. Box 419
Laredo, Texas 78042

Notice of address change may be given any time pursuant to the provisions of this Section 6.

7. Term:

These Terms shall be effective upon consummation of the control authority granted in the Decision for a term of ninety-nine (99) years. These Terms shall terminate, and all rights conferred pursuant thereto shall be canceled and deemed void ab initio, if, in a Final Order, the application for authority for UP to control SPC has been denied or has been approved on terms unacceptable to the applicants or has been granted on terms that do not require the rights provided herein, provided, however, that if these Terms become effective and are later terminated, any liabilities arising from the exercise of rights under Sections 1 through 5 during the period of its effectiveness shall survive such termination. For purposes of this Section 7, "Final Order" shall mean an order of the Surface Transportation Board, any successor agency, or a court with lawful jurisdiction over the matter which is no longer subject to any further direct judicial review (including a petition for writ of certiorari) and has not been stayed or enjoined.

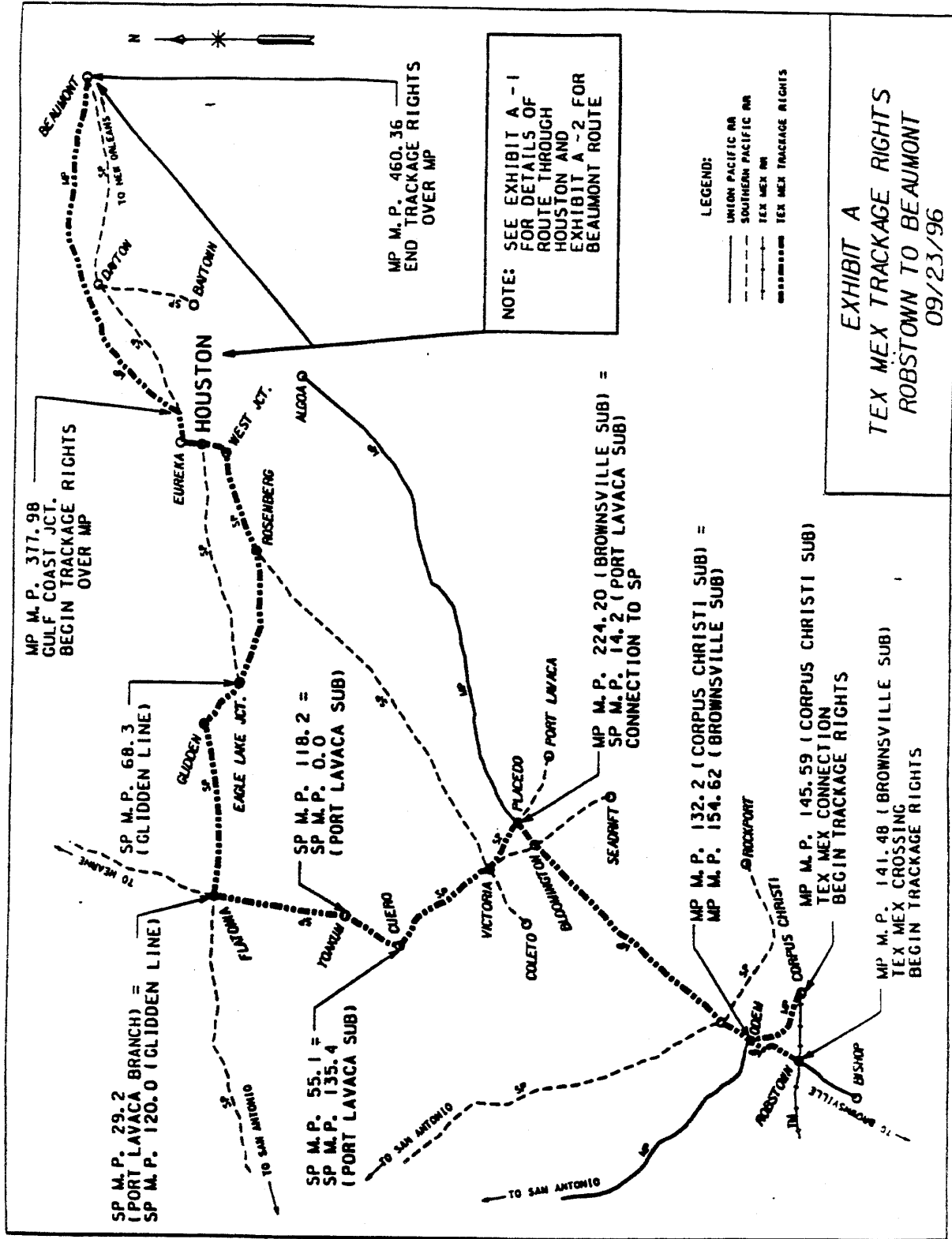
Approved:

For MP/SP:

Jane V. Dean
Position: Vice President - Law
Date: DEC 12 1996

For Tex Mex:

Henry W. Fields
Position: President
Date: Nov 20, 1996



MP M.P. 377.98 (BEAUMONT SUB)
GULF COAST JCT.
BEGIN TRACKAGE RIGHTS
OVER MP

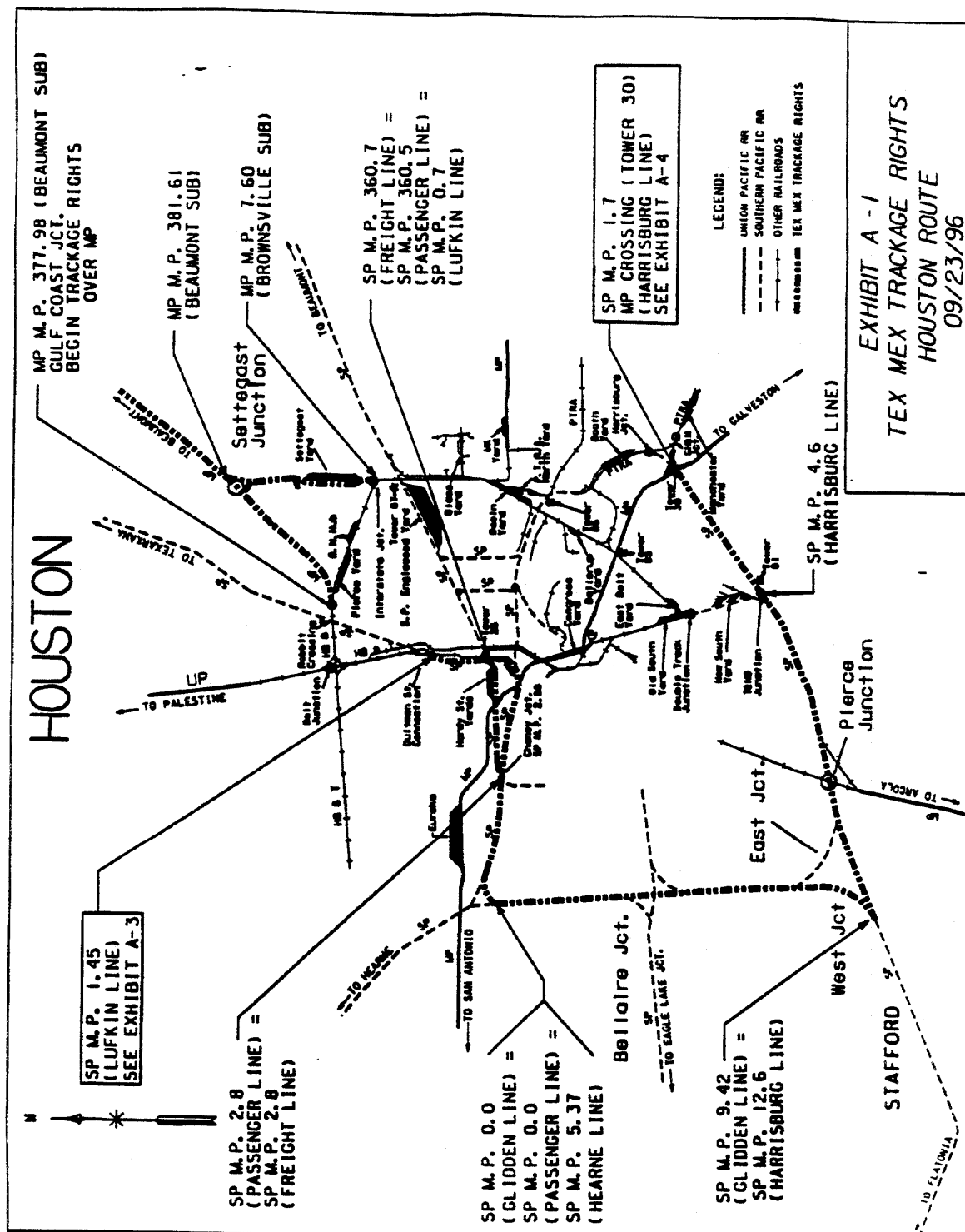


EXHIBIT A -1
TTEX MEX TRACKAGE RIGHTS
HOUSTON ROUTE
09/23/96

BEAUMONT, TEXAS

MP M.P. 451.4
P.S. AMELIA

MP M.P. 456.7 =
SP M.P. 282.4
LANGHAM ROAD

SP M.P. 280.1 =
MP M.P. 458.69
TOWER 74

MP (SP)

M.P. BEAUMONT YARD

MP M.P. 460.36 =
KCS M.P. 766.78
BEGIN KCS

KCS M.P. 765.70
KCS YARD CONN.

TOWER 31

BEAUMONT (KCS)

KCS-UP JUNCTION

NECHES RIVER

BRACKES BAYOU

TO KIRSTVILLE

TO MACDOUGHERS

TO PORT ARTHUR

TO DAYTON/HOUSTON

TO PORT ARTHUR

LEGEND:

- UNION PACIFIC RR
- SOUTHERN PACIFIC RR
- OTHER RAILROADS
- TEX MEX TRACAGE RIGHTS

EXHIBIT A - 2
TEX MEX TRACAGE RIGHTS
BEAUMONT, TEXAS
09/23/96

EXHIBIT A - 2
MEX TRACAGE RIGHTS
BEAUMONT, TEXAS
09/23/96

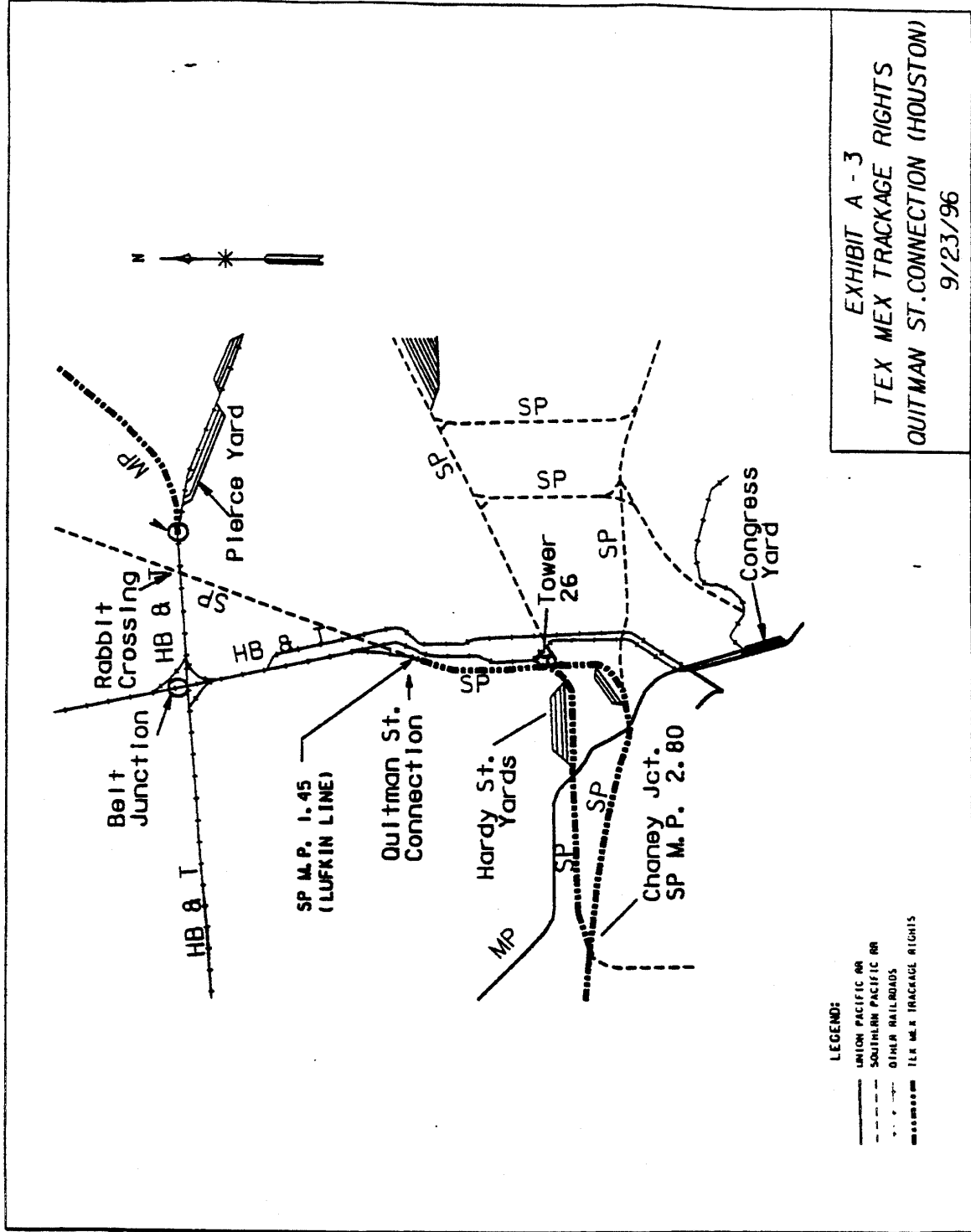


EXHIBIT "B"
GENERAL CONDITIONS

Section 1. **DEFINITIONS**

- 1.1 "Annual" shall mean a calendar year.
- 1.2 "Car" shall mean one (1) rail car; provided, however, that each platform in an articulated rail car of two (2) or more platforms shall be counted as one (1) rail car, subject to modification by mutual agreement of the parties based upon changes in railroad technology.
- 1.3 "Changes in and/or Additions to" shall mean work projects and retirements, the cost of which is chargeable in whole or in part to Property Accounts during the term of the Terms.
- 1.4 "Equipment" shall mean trains, locomotives, rail cars (loaded or empty), intermodal units (loaded or empty), cabooses, vehicles, and machinery which are capable of being operated on railroad tracks or on right-of-way for purposes of the maintenance or repair of such railroad tracks.
- 1.5 "GTM" shall mean gross ton mile which is the weight in tons for Equipment and lading transported over one (1) mile of track included in the Joint Trackage.
- 1.6 "GTM Handled Proportion" shall mean the GTMs handled over the Joint Trackage by or for a party divided by the total number of GTMs handled by or for all parties using the Joint Trackage, during the same period. For the purpose of computing such GTM's Handled Proportion, Equipment engaged in work service pertaining to construction, maintenance or operation of the Joint Trackage or Changes in and/or Additions to the Joint Trackage shall not be counted and GTMs of third parties shall be attributed to the Owner.
- 1.7 "Joint Trackage" shall mean the track structure of Owner as described in the Terms including necessary right-of-way and all appurtenances, signals, communications, and facilities of Owner and all Changes in and/or Additions to said track structure now or in the future located as are required or desirable for the operation of the Equipment of the parties hereto.
- 1.8 "Mill" shall mean one-tenth of a cent (\$0.001 US).
- 1.9 "Owner" shall have the meaning given to it in the Terms.
- 1.10 "Property Accounts" shall mean accounts so designated under the Uniform System of Accounts for Railroad Companies prescribed by the Interstate Commerce Commission, or any replacement of such system prescribed by the applicable federal regulatory agency, if any, and used by the parties hereto.

1.11 "STB" shall mean the Surface Transportation Board of the United States Department of Transportation or any successor agency.

1.12 "Terms" shall mean those certain Terms for Texas Mexican Railway Company Trackage Rights to which this Exhibit "B" is attached.

1.13 "User" shall have the meaning given to it in the Terms.

Section 2. MAINTENANCE, ADDITIONS, OPERATION, AND CONTROL

2.1 Owner shall have sole charge of the maintenance and repair of the Joint Trackage with its own supervisors, labor, materials and equipment. Owner, from time to time, may make such Changes in and/or Additions to the Joint Trackage as shall be required by any law, rule, regulation or ordinance promulgated by any government body having jurisdiction, or as Owner, in its sole discretion, shall deem necessary, subject to Section 2.2. Such Changes in and/or Additions to the Joint Trackage shall become a part of the Joint Trackage or in the case of retirements shall be excluded from the Joint Trackage.

2.2 Unless otherwise mutually agreed to by the parties in writing, Owner shall, (i) keep and maintain the Joint Trackage on a consistent basis at no less than the track standard designated in the timetable in effect on the date of the Terms, including special instructions for the Joint Trackage as of the date of the Terms, (ii) maintain at least the physical capacity of the Joint Trackage as of the date of the Terms (i.e., number of main tracks, support tracks, signal systems, rail weight, line clearances, etc.), and (iii) be responsible for any Changes in and/or Additions to the Joint Trackage as shall be necessary to accommodate the traffic of Owner and User while maintaining existing service standards (including transit times) in effect on the date of the Terms. In the event that User desires that the Joint Trackage be improved to a condition in excess of the standard set forth in this Section 2.2, or desires that other Changes in and/or Additions to be made to the Joint Trackage, Owner agrees to make such Changes in and/or Additions to the Joint Trackage if funded in advance by User. Thereafter, such Changes in and/or Additions to the Joint Trackage shall become part of the Joint Trackage and shall be maintained by Owner in such improved condition.

2.3 Owner shall employ all persons necessary to construct, operate, maintain, repair and renew the Joint Trackage. Owner shall be bound to use reasonable and customary care, skill and diligence in the construction, operation, maintenance, repair and renewal of the Joint Trackage and in managing of the same. Owner shall make its best effort to ensure that User is given the same advance notice of maintenance plans and schedules as is provided to Owner's personnel.

2.4 The trackage rights granted hereunder shall give User access to and joint use of the Joint Trackage, for such use as is permitted by Section 2 of the Terms, equal to that of Owner. The management, operation (including dispatching) and maintenance of the Joint Trackage shall, at all times, be under the exclusive direction and control of Owner, the movement

of Equipment over and along the Joint Trackage shall at all times be subject to the exclusive direction and control of Owner's authorized representatives and in accordance with such reasonable operating rules as Owner shall from time to time institute, but in the management, operation (including dispatching) and maintenance of the Joint Trackage, Owner and User shall be treated equally. All operating, dispatching and maintenance decisions by Owner affecting the movement of Equipment on the Joint Trackage shall be made pursuant to the Tex Mex-UP SP Dispatching Protocols attached hereto as Attachment 1. User shall, at User's sole cost and expense, obtain, install and maintain necessary communication equipment to allow User's Equipment to communicate with Owner's dispatching and signaling facilities the same as Owner's trains so utilize. Owner shall consult with User prior to the adoption of new communication or signaling systems to be employed on the Joint Trackage, which have not theretofore been generally adopted in the railroad industry.

2.5 A Joint Service Committee ("Committee"), comprised of the chief transportation officers of Owner and User (or their designees) shall be established, and shall be responsible for establishing rules and standards as appropriate to ensure equitable and non-discriminatory treatment, appropriate maintenance and efficient joint use of the Joint Trackage. The Committee shall meet on a regular basis, but not less often than every three (3) months during the first year of operation under the Agreement, and thereafter when any party serves upon the other party thirty (30) days' written notice of its desire to meet to review the overall performance of equipment on the Joint Trackage, conflicts, if any, experienced between Equipment of Owner and Equipment of User, grievances over the handling of particular Equipment or operational events, maintenance of the Joint Trackage, ways in which future conflicts may be minimized, ways of improving operations and maintenance of the Joint Trackage and such other relevant matters as the Committee may decide to consider. The Committee may issue standards or rules to prevent unnecessary interference or impairment of use of the Joint Trackage by either party or otherwise insure fair and equal treatment as between Owner and User. Either party may request a special meeting of the Committee on reasonable notice to the other. Informal telephonic conferences shall be held by the Committee where appropriate to address immediate concerns of either party. It is expected that the work of the Committee shall be undertaken in a spirit of mutual cooperation consistent with the principles expressed in the Terms.

2.6 If the use of the Joint Trackage shall at any time be interrupted or traffic thereon or thereover be delayed for any cause, neither party shall have or make any claim against the other for loss, damage or expense caused by or resulting solely from such interruption or delay.

2.7 Owner may from time to time provide any track or tracks on the Joint Trackage other than those delineated in Exhibit A to the Terms for use by User provided there shall at all times be afforded User a continuous route of equal utility and quality for the operations of its Equipment between the termini of the Joint Trackage. When such tracks which are not part of the Joint Trackage are used as provided herein, the Terms shall govern for purposes of direction and control and liability as if all movement had been made over the Joint Trackage.

2.8 Each party shall be responsible for furnishing, at its sole cost and expense, all labor, fuel and train and other supplies necessary for the operation of its own Equipment over the Joint Trackage. In the event a party does furnish such labor, fuel or train and other supplies to another party, the party receiving the same shall promptly, upon receipt of billing therefor, reimburse the party furnishing the same for its reasonable costs thereof, including customary additives.

2.9 User shall be responsible for the reporting and payment of any mileage, per diem, use or rental charges accruing on Equipment in User's account on the Joint Trackage. Except as may be specifically provided for in the Terms, nothing herein contained is intended to change practices with respect to interchange of traffic between the parties or with other carriers on or along the Joint Trackage.

2.10 Except as otherwise may be provided in the Terms, User shall operate its Equipment over the Joint Trackage with its own employees, but before said employees are assigned or permitted to operate Equipment over the Joint Trackage as herein provided, and from time to time thereafter as and when reasonably requested by Owner, they shall be required to pass the applicable rules examinations required by Owner of its own employees. Owner shall delegate to specified User's officers the conduct of such examinations in the event User chooses to conduct such examinations. If an Owner officer conducts such examinations of employees of User, User shall pay Owner a reasonable fee for each employee so examined, such fee to be mutually agreed upon by the parties from time to time in a separate agreement. Notwithstanding any such examination, User shall be responsible for ensuring that its employees are qualified and have taken all such rules examinations. Upon request of User, Owner shall qualify one or more of User's supervisory officers as pilots and such supervisory officer or officers so qualified shall qualify employees of User engaged in or connected with User's operations on or along the Joint Trackage. At User's request, Owner shall furnish a pilot or pilots, at the expense of User, to assist in operating trains of User over the Joint Trackage.

2.11 If any employee of User shall neglect, refuse or fail to abide by Owner's rules, instructions and restrictions governing the operation on or along the Joint Trackage, such employee shall, upon written request of Owner, be suspended by User from working on the Joint Trackage unless and until requalified to return to work and approved to do so by Owner. If either party shall deem it necessary to hold a formal investigation to establish such neglect, refusal or failure on the part of any employee of User, then upon such notice presented in writing, Owner and User shall promptly hold a joint investigation in which the parties concerned shall participate and bear the expense for their respective officers, counsel, witnesses and employees. Notice of such investigations to User's employees shall be given by User's officers, and such investigation shall be conducted in accordance with the terms and conditions of schedule agreements between User and its employees. If, in the judgment of Owner, the result of such investigation warrants, such employee shall, upon written request by Owner, be withdrawn by User from service on the Joint Trackage, and User shall release and indemnify Owner from and against any and all claims and expenses arising from such withdrawal.

If the disciplinary action is appealed by an employee of User to the National Railroad Adjustment Board or other tribunal lawfully created to adjudicate such cases; and if the decision of such board or tribunal sustains the employee's position, such employee shall not thereafter be barred from service on the Joint Trackage by reason of such disciplinary action.

2.12 If any Equipment of User is bad ordered enroute on the Joint Trackage and (i) it is necessary that it be set out, and (ii) only light repairs to the Equipment are required, such bad ordered Equipment shall be promptly repaired, and, thereafter, be promptly removed from the Joint Trackage by User. Owner may, upon request of User and at User's sole cost and expense, furnish the required labor and material and perform light repairs to make such bad ordered Equipment safe for movement. The employees and Equipment of Owner while in any manner so engaged or while enroute to or returning to Owner's terminal from such an assignment shall be considered Sole Employees (as hereinafter defined) of User and Sole Property (as hereinafter defined) of User. However, should Owner's employees after repairing such bad ordered Equipment for User move directly to perform service for Owner's benefit rather than return to Owner's terminal, then User's exclusive time and liability will end when Owner's employees depart for work to be performed for Owner's benefit. In the case of such repairs by Owner to freight cars in User's account, billing therefor shall be in accordance with the Field and Office Manuals of the Interchange Rules, adopted by the Association of American Railroads ("AAR"), hereinafter called "Interchange Rules", in effect on the date of performance of the repairs. Owner shall then prepare and submit billing directly to and collect from the car owner for car owner responsibility items as determined under said Interchange Rules, and Owner shall prepare and submit billing directly to and collect from User for handling line responsibility items as determined under said Interchange Rules. Owner also shall submit billing to and collect from User any charges for repair to freight cars that are User's car owner responsibility items as determined under said Interchange Rules, should said car owner refuse or otherwise fail to make payment therefor. Repairs to locomotives shall be billed as provided for in Section 3 of these General Conditions.

2.13 If Equipment of User shall become derailed, wrecked, or otherwise disabled while upon the Joint Trackage, it shall be rerailed or cleared by Owner, except that employees of User may rerail User's derailed Equipment on the Joint Trackage whenever use of motorized on or off track equipment is not required; however, in any such case, employees of User shall consult with and be governed by the directions of Owner. Owner reserves the right to rerail Equipment of User when, in the judgment of Owner, Owner deems it advisable to do so to minimize delays and interruptions to train movement. The reasonable costs and expenses of rerailing or clearing derailed, wrecked or disabled Equipment shall be borne by the parties in accordance with Section 5 of these General Conditions. Services provided under this section shall be billed in accordance with Section 3 of these General Conditions.

2.14 In the event Equipment of User shall be forced to stop on the Joint Trackage, and such stoppage is due to insufficient hours of service remaining among User's employees, or due to mechanical failure of User's Equipment (other than bad ordered Equipment subject to light repairs pursuant to Section 2.12), or to any other cause not resulting from an accident or

derailment (including the failure of User to promptly repair and clear bad ordered Equipment pursuant to Section 2.12), and such Equipment is unable to proceed, or if a train of User fails to maintain the speed required by Owner on the Joint Trackage, or if, in emergencies, disabled Equipment is set out of User's trains on the Joint Trackage, Owner shall have the option to furnish motive power or such other assistance (including but not limited to the right to recrew User's train) as may be necessary to haul, help or push such Equipment, or to properly move the disabled Equipment off the Joint Trackage. The reasonable costs and expenses of rendering such assistance shall be borne by User. Services provided under this section shall be billed in accordance with Section 3 of these General Conditions.

2.15 User shall pay to Owner reasonable expenses incurred by Owner in the issuance of timetables made necessary solely by changes in the running time of the trains of User over the Joint Trackage. If changes in running time of trains of Owner or third parties, as well as those of User, require the issuance of timetables, then User shall pay to Owner that proportion of the expenses incurred that one bears to the total number of parties changing the running time of their trains. If changes in running time of trains of Owner or third parties, but not those of User, require the issuance of timetables, then User shall not be required to pay a proportion of the expenses incurred in connection therewith.

2.16 User, at Owner's request, shall be responsible for reporting to Owner the statistical data called for in the Terms, which may include, but is not limited to, the number and type of Equipment and GTMs operated on the Joint Trackage.

Section 3. BILLING

3.1 Billing shall be accomplished on the basis of data contained in a billing form mutually agreed to between the parties. Such billing forms shall contain sufficient detail to permit computation of payments to be made hereunder. Billing shall be prepared according to the rules, additives, and equipment rental rates as published by the Owner. User shall pay to Owner at the Office of the Treasurer of Owner, or at such other location as Owner may from time to time designate in writing, all the compensation and charges of every name and nature which in and by the Terms User is required to pay in lawful money of the United States within sixty (60) days after the rendition of bills therefor. Bills shall contain a statement of the amount due on account of the expenses incurred, properties and facilities provided and services rendered during the billing period.

3.2 Errors or disputed items in any bill shall not be deemed a valid excuse for delaying payment, but shall be paid subject to subsequent adjustment; provided, no exception to any bill shall be honored, recognized or considered if filed after the expiration of three (3) years from the last day of the calendar month during which the bill is rendered and no bill shall be rendered later than three (3) years (i) after the last day of the calendar month in which the expense covered thereby is incurred, or (ii) in the case of claims disputed as to amount or liability, after the amount is settled and/or the liability is established. This provision shall not limit the retroactive

adjustment of billing made pursuant to exception taken to original accounting by or under authority of the STB or retroactive adjustment of wage rates and settlement of wage claims.

3.3 So much of the books, accounts and records of each party hereto as are related to the subject matter of the Terms shall at all reasonable times be open to inspection by the authorized representatives and agents of the parties hereto. All books, accounts, and records shall be maintained to furnish readily full information for each item in accordance with any applicable laws or regulations.

3.4 Should any payment become payable by Owner to User under the Terms, the provisions of Sections 3.1 and 3.2 of these General Conditions shall apply with User as the billing party and Owner as the paying party.

3.5 Either party hereto may assign any receivables due it under the Terms; provided, however, that such assignments shall not relieve the assignor of any rights or obligations under the Terms.

Section 4. COMPLIANCE WITH LAWS

4.1 With respect to operation of Equipment on the Joint Trackage, each party shall comply with all applicable federal, state and local laws, rules, regulations, orders, decisions and ordinances ("Standards"), and if any failure on the part of any party to so comply shall result in a fine, penalty, cost or charge being imposed or assessed on or against another party, such other party shall give prompt notice to the failing party and the failing party shall promptly reimburse and indemnify the other party for such fine, penalty, cost or charge and all expenses and reasonable attorneys' fees incurred in connection therewith, and shall upon request of the other party defend such action free of cost, charge and expense to the other party.

4.2 User agrees to comply fully with all applicable Standards concerning "hazardous waste" and "hazardous substances" ("Hazardous Materials"). Except with Owner's prior consent, User covenants that it shall not treat or dispose of Hazardous Materials on the Joint Trackage. User further agrees to furnish Owner (if requested) with proof, satisfactory to Owner, that User is in such compliance.

In the event any accident, bad ordered Equipment, derailment, vandalism or wreck (for purposes of this Section 4.2 and Section 4.3 hereinafter called collectively "Derailment") involving Equipment of or a train operated by User carrying Hazardous Materials shall occur on any segment of the Joint Trackage, any report required by federal, state or local authorities shall be the responsibility of User. User shall also advise the owner/shipper of the Hazardous Materials involved in the Derailment, and Owner, immediately.

In the event of a Derailment, Owner shall assume responsibility for cleaning up any release of Hazardous Materials from User's Equipment in accordance with all federal, state, or local regulatory requirements. User may have representatives at the scene of the Derailment to

observe and provide information and recommendations concerning the characteristics of Hazardous Materials release and the cleanup effort. Such costs shall be borne in accordance with Section 5 of these General Conditions.

If a Hazardous Materials release caused by a derailment involving Equipment of User, or on a train operated by User, results in contamination of real property or water on the Joint Trackage or on real property or water adjacent to the Joint Trackage (whether such real property or water is owned by Owner or a third party), Owner shall assume responsibility for emergency cleanup conducted to prevent further damage. User shall be responsible for performing cleanup efforts thereafter. Any costs associated with cleaning up real property or water on or adjacent to the Joint Trackage contaminated by Hazardous Materials shall be borne in accordance with Section 5 of these General Conditions.

If Hazardous Materials must be transferred to undamaged Equipment or trucks as a result of a release caused by a derailment involving Equipment of User, or on a train operated by User, User shall perform the transfer; PROVIDED, HOWEVER, that if the Hazardous Materials are in damaged Equipment that is blocking the Joint Trackage, Owner, at its option, may transfer the Hazardous Materials with any costs associated with such transfer borne in accordance with Section 5 of these General Conditions. Transfers of Hazardous Materials by User shall only be conducted after being authorized by Owner.

4.3 The total cost of clearing a Derailment, cleaning up any Hazardous Materials released during such Derailment, and/or repairing the Joint Trackage or any other property damaged thereby shall be borne by the party or parties liable therefor in accordance with Section 5 of these General Conditions.

4.4 In the event of release of Hazardous Materials caused by faulty Equipment or third parties, cleanup will be conducted as stated in Sections 4.2 and 4.3 of these General Conditions.

Section 5. LIABILITY

5.1 General. The provisions of this Section 5 shall apply only as between the parties hereto and are solely for their benefit. Nothing herein is intended to be for the benefit of any person or entity other than the parties hereto. It is the explicit intention of the parties hereto that no person or entity other than the parties hereto is or shall be entitled to bring any action to enforce any provision hereof against any of the parties hereto, and the assumptions, indemnities, covenants, undertakings and agreements set forth herein shall be solely for the benefit of, and shall be enforceable only by, the parties hereto. Notwithstanding anything contained in this Section 5, no provisions hereof shall be deemed to deprive Owner or User of the right to enforce or shall otherwise restrict any remedies to which they would otherwise be entitled under other provisions of the Terms as a result of the other party's failure to perform or observe any other obligation or duty created by the Terms. The provisions of this Section 5 shall apply as between the parties hereto irrespective of the terms of any other agreements between the parties hereto and

other railroads using the Joint Trackage, and the allocation of liabilities provided for herein shall control as between the parties hereto.

5.2 Definitions and Covenants. The parties agree that for the purposes of this Section 5:

(a) The term "Employee(s)" of a party shall mean all officers, agents, employees and contractors of that party. Such Employees shall be treated either as "Sole Employees" or "Joint Employees", as hereinafter specified:

(b) "Sole Employees" and "Sole Property" shall mean one or more Employees, Equipment, tools and other equipment and machinery while engaged in, en route to or from, or otherwise on duty incident to performing service for the exclusive benefit of one party. Pilots furnished by Owner to assist in operating Equipment of User shall be considered the Sole Employees of User while engaged in such operations. Equipment shall be deemed to be the Sole Property of the party receiving the same at such time as deemed interchanged under AAR rules or applicable interchange agreements, or when such party is responsible for the car hire or per diem for the Equipment under agreement between the parties:

(c) "Joint Employee" shall mean one or more Employees while engaged in maintaining, repairing, constructing, renewing, removing, inspecting or managing the Joint Trackage or making Changes in and/or Additions to the Joint Trackage for the benefit of both of the parties hereto, or while preparing to engage in, en route to or from, or otherwise on duty incident to performing such service for the benefit of both parties:

(d) "Joint Property" shall mean the Joint Trackage and all appurtenances thereto, and all Equipment, tools and other equipment and machinery while engaged in maintaining, repairing, constructing, renewing, removing, inspecting, managing or making Changes in and/or Additions to the Joint Trackage for the benefit of both of the parties hereto, or while being prepared to engage in, en route to or from, or otherwise incident to performing such service:

(e) "Loss and/or Damage" shall mean injury to or death of any person, including Employees of the parties hereto, and loss or damage to any property, including property of the parties hereto and property being transported by the parties, which arises out of an incident occurring on, the Joint Trackage and shall include liability for any and all claims, suits, demands, judgments and damages resulting from or arising out of such injury, death, loss or damage, except liability for punitive and exemplary damages. Loss and/or Damage shall include all costs and expenses incidental to any claims, suits, demands and judgments, including attorneys' fees, court costs and other costs of investigation and litigation. Loss and/or Damage shall further include the expense of clearing wrecked or derailed Equipment and the costs of environmental protection, mitigation or clean up necessitated by such wreck or derailment and shall include any liabilities for any third-party claims for personal injury or death, property damage, natural

resource damage, or any penalties, judgments or fines associated with a release of any contaminants resulting from such wreck or derailment:

(f) Operating Employees of Owner whose service may be jointly used by the parties hereto for the movement of trains over the Joint Trackage, including, but not limited to, train dispatchers, train order operators, operator clerks and watchmen shall at the time of performing their services be deemed to be Sole Employees of the party hereto for whose benefit said services may be separately rendered (during the time they are so separately rendered) and be deemed to be Joint Employees of the parties hereto at such time as their services may be rendered for the parties' joint benefit:

(g) All Employees, Equipment, tools and other equipment and machinery other than as described in (b), (c), (d) or (f) above or in Section 5.4, shall be deemed the Sole Employees of the employing party and the Sole Property of the using party:

(h) Any railroad not a party to the Terms heretofore or hereafter admitted to the use of any portion of the Joint Trackage, shall, as between the parties hereto, be regarded in the same light as a third party. Without limiting the generality of the foregoing, neither of the parties hereto assumes any responsibility to the other under the provisions of the Terms for any Loss and/or Damage occasioned by the acts or omissions of any employees of any such other railroad, or for any Loss and/or Damage which such other railroad shall be obligated to assume in whole or in part pursuant to law or any agreement relating to such other railroad's use of any portion of the Joint Trackage:

(i) For the purpose of this Section 5, Equipment of foreign lines being detoured over the Joint Trackage, and all persons other than Joint Employees engaged in moving such Equipment, shall be considered the Equipment and Employees of the party hereto under whose detour agreement or other auspices such movement is being made.

5.3 Reimbursement and Defense. The parties agree that:

(a) Each party hereto shall pay promptly Loss and/or Damage for which such party shall be liable under the provisions of this Section 5, and shall indemnify the other party against such Loss and/or Damage, including reasonable attorneys' fees and costs. If any suit or suits shall be brought against either of the parties hereto and any judgment or judgment shall be recovered which said party is compelled to pay, and the other party shall under the provisions of the Terms be solely liable therefor, then the party which is so liable shall promptly repay on demand to the other party paying the same any monies which it may have been required to pay, whether in the way of Loss and/or Damage, costs, fees or other expenses; and if the Loss and/or Damage in such case or cases is joint or allocated between the parties to the Terms, the party defendant paying the same or any costs, fees or other expenses shall be reimbursed by the other party as allocated pursuant to the Terms;

(b) Each party covenants and agrees with the other party that it will pay for all Loss and/or Damage, both as to persons and property, and related costs which it has herein assumed, or agreed to pay, the judgment of any court in a suit by third party or parties to the contrary notwithstanding, and will forever indemnify and save harmless the other party, its successors and assigns, from and against all liability and claims therefor, or by reason thereof, and will pay, satisfy and discharge all judgments that may be rendered by reason thereof, and all costs, charges and expenses incident thereto:

(c) Each party hereto shall have the sole right to settle, or cause to be settled for it, all claims for Loss and/or Damage for which such party shall be solely liable under the provisions of this Section 5, and the sole right to defend or cause to be defended all suits for the recovery of any such Loss and/or Damage for which such party shall be solely liable under the provisions of this Section 5:

(d) User shall provide written notice to Owner of any accidents or events resulting in Loss and/or Damage within seven (7) days of its discovery or receipt of notification of such occurrence:

(e) In the event both parties hereto may be liable for any Loss and/or Damage under the provisions of this Section 5 ("Co-Liable"), and the same shall be settled by a voluntary payment of money or other valuable consideration by one of the parties Co-Liable therefor, release from liability shall be taken to and in the name of all the parties so liable; however, no such settlement in excess of the sum of One Hundred Thousand Dollars (\$100,000) shall be made by or for any party Co-Liable therefor without the written consent of the other parties so liable, but any settlement made by any party in consideration of One Hundred Thousand Dollars (\$100,000) or a lesser sum shall be binding upon the other parties and allocated in accordance with Section 5.5; and no party shall unreasonably withhold its consent to a settlement proposed by the other party; provided, however, that failure by a party to secure consent from the other shall not release such other party to the extent the party who failed to obtain such consent demonstrates that the other party was not prejudiced by such failure.

(f) In case a claim or suit shall be commenced against any party hereto for or on account of Loss and/or Damage for which another party hereto is or may be solely liable or Co-Liable under the provisions of this Section 5, the party against whom such claim or suit is commenced shall give to such other party prompt notice in writing of the pendency of such claim or suit, and thereupon such other party shall assume or join in the defense of such claim or suit as follows: If the claim or suit involves Loss and/or Damage to the Sole Employees or Sole Property of a party or its invitee or property in its care, custody or control, that party shall assume and control the investigation and defense of such claim or suit.

if the claim or suit involves Loss and/or Damage to third parties. Joint Employees or the Joint Trackage, the party whose Sole Employees or Equipment were involved in the incident shall investigate and defend such claim or suit; and if such claim or suit involves Loss and/or Damage to third parties. Joint Employees or the Joint Trackage and neither or both party's Equipment and Sole Employees were involved in the incident. Owner shall investigate and defend such claim or suit; provided that the other party also may participate in the defense of any of the foregoing if it may have liability as a result of such incident:

(g) No party hereto shall be conclusively bound by any judgments against the other party, unless the former party shall have had reasonable notice requiring or permitting it to investigate and defend and reasonable opportunity to make such defense. When such notice and opportunity shall have been given, the party so notified and the other party shall be conclusively bound by the judgment as to all matters which could have been litigated in such suit, including without limitation a determination of the relative or comparative fault of each.

5.4 Wrecks and Derailment. The cost and expense of repairing bad ordered Equipment, clearing wrecks or otherwise disabled Equipment or rerailing Equipment (and the costs of repair or renewal of damaged Joint Trackage or adjacent properties) shall be borne by the party whose Equipment was wrecked, disabled, or derailed or caused such damage. All Employees or Equipment, while engaged in, en route to or from, or otherwise incident to operating wrecker or work trains clearing wrecks, disabled Equipment or Derailments or engaged in repair or renewal of the Joint Trackage subsequent to any such wreck, disability or Derailment, shall be deemed to be Sole Employees and/or Sole Property of the party whose Equipment was wrecked, disabled or derailed. However, such Employees or Equipment, while en route from performing such clearing of wrecks, disabled Equipment or Derailments or repairing or renewing the Joint Trackage to perform another type of service, shall not be deemed to be performing service incident to the instant wreck, disability or Derailment.

5.5 Allocation.

(a) Each party shall bear all costs of Loss and/or Damage to its Sole Employees or its Sole Property, or property in its care, custody or control or its invitees without regard to which party was at fault.

(b) Loss and/or Damage to third parties (i.e., any person or entity other than a party hereto, a Sole Employee of either party, a Joint Employee or an invitee of either party) or their property, to Joint Employees or their property or to Joint Property shall be borne by the parties hereto as follows:

(i) If the Loss and/or Damage is attributable to the acts or omissions of only one party hereto, that party shall bear and pay all of such Loss and/or Damage.

(ii) If such Loss and/or Damage is attributable to the acts or omissions of more than one party hereto, such Loss and/or Damage shall be borne and paid by those parties in accordance with a comparative negligence standard, whereby each such party shall bear and pay a portion of the Loss and/or Damage equal to the degree of causative fault or percentage of responsibility for the Loss and/or Damage attributable to that party without regard to laws limiting recovery if one party is more than fifty percent (50%) at fault.

(iii) Loss and/or Damage to third parties or Joint Employees occurring in such a way that it cannot be determined how such Loss and/or Damage came about shall be apportioned between Owner, User and any other party(ies) authorized to use the Joint Trackage as a trackage rights tenant, on a usage basis considering each party's gross ton miles over the Joint Trackage for the preceding twelve (12) months or, if such Loss and/or Damage occurs during the first twelve (12) months following the effective date of the Terms, the usage of each party between the occurrence of such Loss and/or Damage and the effective date of the Terms, provided that, without limitation, User shall not bear or incur any liability for claims, suits, demands, judgments, losses or damages resulting from environmental contamination of or hazardous material on or released from the Joint Trackage, except contamination or a release of hazardous materials from User's own Equipment or caused by or arising from the actions or omissions of User or User's Employees, and then only in accordance with the other provisions hereof.

(c) The parties agree that the characterization herein of certain Employees as "Sole Employees" or "Joint Employees" is only for the purpose of allocating Loss and/or Damage suffered by those Employees. Except as specified in subsection (a) of this Section 5.5, (which provides for the allocation of certain Loss and/or Damage between the parties without regard to fault), no party shall be liable for the acts or omissions (negligent or otherwise) of any other party's Employee.

5.6 OWNER AND USER EXPRESSLY INTEND THAT WHERE ONE PARTY IS TO INDEMNIFY THE OTHER PURSUANT TO THE TERMS, SUCH INDEMNITY SHALL INCLUDE (1) INDEMNITY FOR THE NEGLIGENCE OR ALLEGED NEGLIGENCE, WHETHER ACTIVE OR PASSIVE, OF THE INDEMNIFIED PARTY WHERE THAT NEGLIGENCE IS A CAUSE OF THE LOSS OR DAMAGE; (2) INDEMNITY FOR STRICT LIABILITY OF THE INDEMNIFIED PARTY RESULTING FROM A VIOLATION OR ALLEGED VIOLATION OF ANY FEDERAL, STATE OR LOCAL LAW OR REGULATION BY THE INDEMNIFIED PARTY, INCLUDING BUT NOT LIMITED TO THE FEDERAL EMPLOYERS LIABILITY ACT ("FELA"), THE SAFETY APPLIANCE ACT, THE BOILER

INSPECTION ACT, THE OCCUPATIONAL SAFETY AND HEALTH ACT ("OSHA"), THE RESOURCE CONSERVATION AND RECOVERY ACT ("RCRA"), THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT ("CERCLA"), THE CLEAN WATER ACT ("CWA"), THE OIL POLLUTION ACT ("OPA"), AND ANY SIMILAR STATE STATUTE IMPOSING OR IMPLEMENTING SIMILAR STANDARDS; AND (3) INDEMNITY FOR ACTS OR ALLEGED ACTS OF GROSS NEGLIGENCE OF THE INDEMNIFIED PARTY, OR OTHER CONDUCT ON THE PART OF THE INDEMNIFIED PARTY FOR WHICH PUNITIVE DAMAGES MIGHT BE SOUGHT.

Section 6. ARBITRATION

6.1 If at any time a question or controversy shall arise between the parties hereto in connection with the Terms upon which the parties cannot agree, such question or controversy shall be submitted to and settled by arbitration. Unless other procedures are agreed to by the parties, arbitration between the parties pursuant to this Section 6 shall be governed by the rules and procedures set forth in this Section 6.

6.2 If the parties to the dispute are able to agree upon a single competent and disinterested arbitrator within twenty (20) days after written notice by one party of its desire for arbitration to the other party, then the question or controversy shall be submitted to and settled by that single arbitrator. Otherwise, any party (the notifying party) may notify the other party (the noticed party) in writing of its request for arbitration and nominating one arbitrator. Within twenty (20) days after receipt of said notice, the noticed party shall appoint an arbitrator and notify the notifying party in writing of such appointment. Should the noticed party fail within twenty (20) days after receipt of such notice to name its arbitrator, said arbitrator may be appointed by the Chief Judge (or acting Chief Judge) of the United States District Court for the District of Columbia upon application by either party after ten (10) days' written notice to the other party. The two arbitrators so chosen shall select one additional arbitrator to complete the board. If the arbitrators so chosen fail to agree upon an additional arbitrator, the same shall, upon application of a party, be appointed by said judge in the manner heretofore stated.

6.3 Upon selection of the arbitrator(s), said arbitrator(s) shall, with reasonable diligence, determine the questions as disclosed in said notice of arbitration, shall give both parties reasonable notice of the time and place (of which the arbitrator(s) shall be the judge) of hearing evidence and argument, may take such evidence as the arbitrator(s) shall deem reasonable or as either party may submit with witnesses required to be sworn, and hear arguments of counsel or others. If an arbitrator declines or fails to act, the party (or parties in the case of a single arbitrator) by whom the arbitrator was chosen or said judge shall appoint another to act in the arbitrator's place.

6.4 After considering all evidence, testimony and arguments, said single arbitrator or the majority of said board of arbitrators shall promptly state such decision or award and the reasoning for such decision or award in writing which shall be final, binding, and conclusive on all parties to the arbitration when delivered to them. The award rendered by the arbitrator(s) may

be entered as a judgment in any court having jurisdiction thereof and enforced as between the parties without further evidentiary proceeding, the same as entered by the court at the conclusion of a judicial proceeding in which no appeal was taken. Until the arbitrator(s) shall issue the first decision or award upon any question submitted for arbitration, performance under the Terms shall continue in the manner and form existing prior to the rise of such question. After delivery of said first decision or award, each party shall forthwith comply with said first decision or award immediately after receiving it.

6.5 Each party to the arbitration shall pay all compensation, costs, and expenses of the arbitrator appointed in its behalf and all fees and expenses of its own witnesses, exhibits, and counsel. The compensation, cost, and expenses of the single arbitrator or the additional arbitrator in the board of arbitrators shall be paid in equal shares by all parties to the arbitration.

6.6 The parties may obtain discovery and offer evidence in accordance with the Federal Rules of Civil Procedure Rules 26 - 37, and Federal Rules of Evidence, as each may be amended from time to time.

6.7 Interest computed annually, at a rate equal to the Prime Rate plus two (2) percentage points, shall be applied to any and all arbitrator's awards requiring the payment of money and shall be calculated from thirty (30) days following the date of the applicable arbitration decision. The term "Prime Rate" shall mean the minimum commercial lending rate charged by banks to their most credit-worthy customers for short-term loans, as published daily in the Wall Street Journal.

Section 7. GOVERNMENTAL APPROVAL AND ABANDONMENT

7.1 Owner and User shall, at their respective cost and expense, initiate by appropriate application or petition and thereafter diligently prosecute proceedings for the procurement of all necessary consent, approval or authority from any governmental agency for the sanction of the Terms and the operations to be carried on or conducted by User thereunder. User and Owner agree to cooperate fully to procure all such necessary consent, approval or authority.

7.2 In the event Owner shall be involuntarily dispossessed, including by threat of condemnation by competent public authority, of the right to operate upon and maintain any portion of its Joint Trackage and Owner fails or declines to replace said Joint Trackage, Owner shall have no obligation hereunder to provide tracks in replacement of such Joint Trackage for User's use, and User shall have and shall make no claim of any kind, legal or otherwise, against Owner for failure to provide such Joint Trackage for User's use.

7.3 To the extent that Owner may lawfully do so, Owner reserves to itself the exclusive right, exercisable at any time during the life of the Terms without concurrence of User, to elect to abandon all or any part of the Joint Trackage by giving six (6) months' prior written notice to User of its intention so to do ("Notice of Abandonment").

Owner shall, concurrent with its Notice of Abandonment, if legally able to do so, give to User the option to purchase the part or parts of the Joint Trackage thereof to be abandoned at the Net Liquidation Value thereof, on the date of said notice; provided, however, it is understood that Burlington Northern Railroad Company and The Atchison, Topeka & Santa Fe Railway Company (collectively, "BNSF") shall be given an option upon the Terms set forth in this Section 7.3, prior to that given User, to purchase the Placedo, Texas to Robstown, Texas segment of the Joint Trackage, subject to User's trackage rights, if BNSF is operating over that segment at the time of its proposed abandonment. "Net Liquidation Value" shall mean fair market value of land and salvage value of track components and other facilities less estimated cost of removal. User shall have three (3) months from the date of receipt of Owner's notice to exercise its option and shall evidence the exercise of its option by giving Owner written notice thereof. Thereafter User shall immediately make appropriate application to secure all necessary governmental authority for such transaction. Within thirty (30) days following the effective date of all requisite governmental approval of the transaction, User shall pay to Owner the amount of money required to purchase said Joint Trackage to be abandoned at the aforesaid Net Liquidation Value. Upon the receipt of payment of such sum, the Terms shall terminate as to the part of the Joint Trackage so purchased by User. Contemporaneously with such payment, by instrument or instruments, Owner shall convey and assign by good and sufficient quit claim deed or deeds, bills of sale or other instruments, all of Owner's right, title, interest and equity, in and to the Joint Trackage so purchased. Owner agrees that it shall promptly take all necessary action to obtain from the trustees of its mortgages all releases or satisfactions covering the same and shall deliver to User such instruments.

If User fails to exercise the option herein granted within the time and in the manner above specified, Owner may forthwith proceed free of all obligation to User to abandon the portion of Joint Trackage or make appropriate application, if necessary, to secure all necessary governmental authority for such abandonment. User agrees that at such time it shall concurrently make application for all necessary governmental authority for abandonment of its right to operate over such Joint Trackage. The Terms shall terminate as to the section of Joint Trackage so abandoned upon the effective date of such approval by governmental authority.

7.4 Owner and User each shall be responsible for and shall bear labor claims, and employee protection payable to, its own respective employees (and employees of its respective affiliated companies) including any amounts that either Owner or User may be required to pay to its own respective employees pursuant to labor protective conditions imposed by the STB.

Section 8. CATASTROPHIC EXPENSE

Catastrophic expense to the Joint Trackage, such as, but not limited to, that arising from flood, earthquake or acts of God, etc., in excess of One Hundred Thousand Dollars (\$100,000) for each occurrence shall be billed in addition to the GTM Rates and apportioned on the basis of the parties' GTMs operated over the Joint Trackage for the twelve (12) month period ending immediately prior to the first day of the month of occurrence.

Section 9. TERM

9.1 User shall have the right to terminate the Terms upon twelve (12) months' prior written notice to Owner. Liabilities created under the Terms, if it becomes effective and is later terminated, shall survive such termination.

9.2 Upon termination of the Terms, or any partial termination, as the applicable case may be, however the same may occur, User shall be released from any and all manner of obligations and shall be deemed to have forever relinquished, abandoned, surrendered and renounced any and all right possessed by User to operate over that part of the Joint Trackage to which such termination applied, and as to such part, User shall forever release and discharge Owner of and from any and all manner of obligations, claims, demands, causes of action, or suits which User might have, or which might subsequently accrue to User growing out of or in any manner connected with, directly or indirectly, the contractual obligations of Owner under the Terms, in all events provided, however, the aforesaid relinquishment, abandonment, surrender, renunciation, release and discharge by User shall not in any case affect any of the rights and obligations of either Owner or User which may have accrued, or liabilities accrued or otherwise, which may have arisen prior to such termination or partial termination. Upon any termination, Owner shall remove from Owner's right of way any connecting track, and any exclusive facility of User, at User's expense with salvage to be delivered to and retained by User. Upon any partial termination of the Terms, however the same may occur, the terms and conditions hereof shall continue and remain in full force and effect for the balance of the Joint Trackage.

Section 10. ASSIGNMENT

The Terms and any rights granted hereunder may not be assigned in whole or in part by User without the prior written consent of Owner except (i) as provided in Section 3.5, and (ii) to the purchaser of substantially all of User's rail properties. The Terms may be assigned by Owner without restriction. In the event of an authorized assignment, the Terms and the operating rights hereunder shall be binding upon the successors and assigns of the parties.

Section 11. DEFAULT

11.1 Notwithstanding the provisions of Section 3 of these General Conditions, either party hereto claiming default of any of the provisions of the Terms (including these General Conditions) shall furnish notice and written demand to the other party for performance or compliance with the covenant or condition of the Terms claimed to be in default, which notice shall specify wherein and in what respect such default is claimed to exist and shall specify the particular Section or Sections of the Terms under which such claim of default is made.

11.2 If the default shall continue for an additional period of thirty (30) days after receipt of such written notice and demand, and such default has not been remedied within said thirty (30) day period, or reasonable steps have not been nor continue to be taken to remedy a failure or default which cannot reasonably be remedied within said thirty (30) day period, and such default

relates to the provisions and terms of the Terms, either party shall resort to binding arbitration provided that the arbitrator shall not have the authority to amend, modify or terminate the Terms.

11.3 Failure of a party to claim a default shall not constitute a waiver of such default. Either party hereto entitled to claim default may waive any such default, but no action by such party in waiving such default shall extend to or be taken to affect any subsequent defaults or impair the rights of either party hereto resulting therefrom.

Section 12. OTHER CONSIDERATIONS

12.1 The Terms and each and every provision hereof is for the exclusive benefit of the parties hereto and not for the benefit of any third party. Nothing herein contained shall be taken as creating or increasing any right in any third person to recover by way of damages or otherwise against any of the parties hereto.

12.2 If any covenant or provision of the Terms not material to the right of User to use the Joint Trackage shall be adjudged void, such adjudication shall not affect the validity, obligation or performance of any other covenant or provision which is in itself valid. No controversy concerning any covenant or provision shall delay the performance of any other covenant or provision. Should any covenant or provision of the Terms be adjudged void, the parties shall make such other arrangements as will effect the purposes and intent of the Terms.

12.3 In the event there shall be any conflict between the provisions of these General Conditions and the Terms, the provisions of the Terms shall prevail, except that the definition of Joint Trackage set forth in Section 1.7 of these General Conditions shall prevail.

12.4 All section headings are inserted for convenience only and shall not affect any construction or interpretation of the Terms.

12.5 Reference to any agency or other organization shall include any successor agency or organization, and reference to any index or methodology (e.g., RCAF-U, URCS, etc.), if such index or methodology ceases to exist or is no longer available, shall include any substantially similar index or methodology selected by the parties or, if the parties fail to agree on such, one determined by binding arbitration under Section 6 of these General Conditions.

END OF EXHIBIT "B"

TEX MEX - MP/SP DISPATCHING PROTOCOLS

1. Scope: These protocols apply on all segments of the Joint Trackage.
2. Purpose: To ensure that Tex Mex and MP/SP trains operating on Joint Trackage are given equal dispatch without any discrimination in promptness, quality of service or efficiently and that the competitiveness of Tex Mex operations on the Joint Trackage is not adversely affected by the fact that MP/SP owns the track.
3. General Instructions: MP/SP will issue written instructions to all personnel (including supervisors) responsible for train dispatching on the Joint Trackage that Tex Mex trains are to be dispatched exactly as if they were trains of the same class of MP/SP and given equal treatment with trains of MP/SP. These instructions will be issued at agreed intervals or at the request of Tex Mex.
4. Monitoring Systems: MP/SP will provide Tex Mex with timely and accurate information about the status of Tex Mex trains operating over the Joint Trackage.
5. Train Information: Tex Mex will provide the MP/SP, and regularly update, information about its expected train operations and schedules (including priorities, time commitments, horsepower per trailing ton, etc.) over the Joint Trackage, preferably using electronic data interchange. Tex Mex and MP/SP will establish run time standards by train category based on expected train volumes for Tex Mex. If train volumes are different than expected then adjustments to run time standards will be made by mutual agreement. Tex Mex will provide reliable and current information about trains approaching the Joint Trackage, including train arrival time and train characteristics, preferably by providing at its expense computer terminals, facilities or capabilities showing trains approaching the Joint Trackage, sufficiently in advance to allow dispatchers to plan for them. MP/SP will provide to Tex Mex advance notice of planned maintenance-of-way projects, line closures and train or equipment restrictions. Tex Mex and MP/SP will consult in advance about maintenance-of-way windows resulting from planned maintenance projects so as to minimize disruptions to the operations of both carriers.
6. Specific Instructions: MP/SP will permit Tex Mex to transmit instructions regarding the requirements of specific trains and shipments to designated dispatching center employees responsible for handling those trains.
7. Train Priorities/Run Time Standards: MP/SP will provide to Tex Mex current procedures for assigning dispatching priorities or rankings to trains and information sufficient to show how those procedures are applied to their own trains. Tex Mex will assign priorities or rankings to its trains operating on the Joint Trackage using MP/SP's procedures, and MP/SP will dispatch Tex Mex trains in accordance with those priorities or rankings. It is understood that

technological advances in computer aided dispatching might result in changes to priority assignment methodologies. The parties agree to discuss technological changes which might affect priority assignment methodologies prior to implementation. The Joint Service Committee will be responsible for reviewing these assignments to ensure that they are applied equitably by both railroads.

8. Entry to Joint Trackage: At points where Tex Mex trains enter the Joint Trackage, entry will be provided by MP/SP on a first-come first-served basis, taking into consideration the relative priorities of affected trains and the specific needs and operating characteristics of individual trains of both railroads. If operating circumstances make strict application of this principle difficult or uncertain, Tex Mex and MP/SP may jointly establish standards for determining sequence of entry to Joint Trackage. The parties will communicate daily on any conflicts concerning entry to the Joint Trackage to gain resolution.
9. Communication: MP/SP will provide to Tex Mex, and keep current, lists of dispatching personnel responsible for dispatching the Joint Trackage and contact numbers. Tex Mex and MP/SP will designate more supervisory employees to serve as the day-to-day contacts for communications about operating changes, service requests and concerns. Where feasible and economical, dedicated phone lines or computer links will be established for these communications.
10. Access to Dispatching Center: Appropriate officials of Tex Mex will be admitted at any time to dispatching facilities and personnel responsible for dispatching the Joint Trackage to review the handling of trains on the Joint Trackage (although both railroads will take reasonable steps to prevent disclosure of proprietary information not relevant to the review). It is understood that management and supervision of dispatching operations is the responsibility of MP/SP.
11. Performance Measurement: Tex Mex and MP/SP will cooperate to develop train performance evaluation methods under which train performance of Tex Mex trains on the Joint Trackage can be compared to train performance of MP/SP's trains on the Joint Trackage for the same train category and priority.
12. Personnel Incentives and Evaluation: In evaluating the performance of employees and supervisors responsible for dispatching the Joint Trackage, MP/SP will consider train performance of Tex Mex trains and effectiveness in cooperating with Tex Mex personnel and meeting Tex Mex service requirements in the same manner as such factors are considered with respect to MP/SP's trains, personnel and requirements. If bonuses, raises or salaries of those persons are affected by performance of MP/SP's trains, performance of Tex Mex's trains shall be considered on the same basis to the extent feasible.

13. Disagreements: The designated contact supervisors are expected to raise questions, disagreements, concerns or disputes about compliance with these protocols promptly as and when any such matters arise and to use their best efforts to resolve them. If a matter is not resolved to the satisfaction of both parties, it will be presented to the Joint Service Committee. If a satisfactory resolution cannot be achieved by the Joint Service Committee the matter will be submitted to binding summary arbitration before a neutral experienced railroad operating official within fourteen days. The parties will agree in advance on the sanctions available to the arbitrator to address failures to comply with these protocols.
14. Modifications: As the ultimate objective of these protocols is the equal, flexible and efficient handling of all trains of Tex Mex and MP/SP on the Joint Trackage, these protocols may be modified at any time by mutual agreement, consistent with that objective.

D



BUILDING AMERICA™

**Union Pacific Railroad
Spring Dispatching Center**

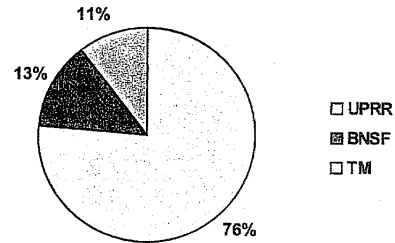
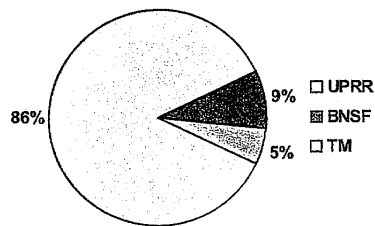
Delay and Train Meet Study
For the Angleton and Brownsville Subs
November 13, 2002 to November 16, 2002

Delays Incurred By Each Railroad

Total Number Of Trains On The Subdivisions

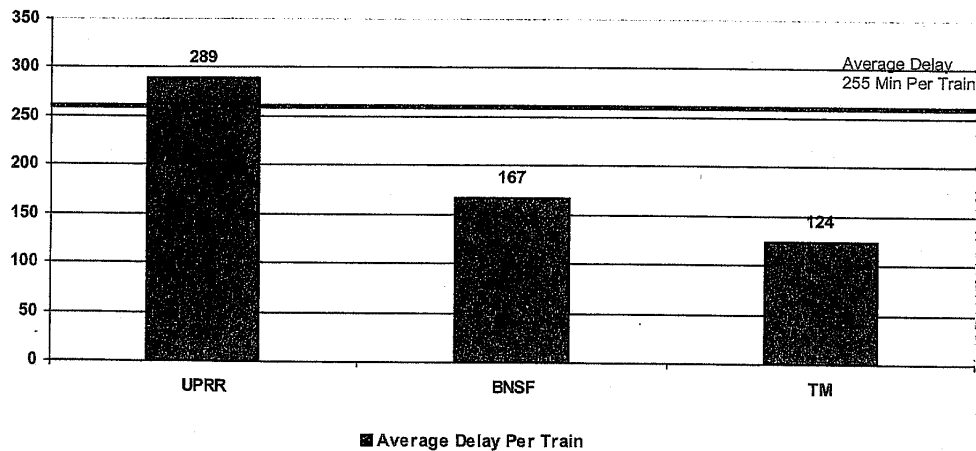
Magnitude Of Delays = UPRR - 16482 Min
BNSF - 1669 Min
TM - 989 Min

Trains Per Railroad = UPRR - 57
BNSF - 10
TM - 8



Average Train Delay Incurred By Each Train

Total Average Delays - Expressed in Minutes



VERIFIED STATEMENT

OF

JERRY A. HAUSMAN

1. I am the MacDonald Professor of Economics at the Massachusetts Institute of Technology ("MIT") in Cambridge, Massachusetts. I graduated from Brown University in 1968. I received a D.Phil. (Ph.D.) in economics from Oxford University in 1973 where I was a Marshall Scholar. I have been at MIT since completing my D.Phil. My academic specialties are econometrics, the application of statistical methods to economic data, and applied microeconomics, the study of behavior by firms and by consumers. I teach a graduate course in applied industrial organization, which is the study of how markets operate. The effect of regulation is a primary topic in the course.

2. I have been an associate editor of *Econometrica*, the leading economics journal, and the *Rand (Bell) Journal of Economics*, the leading journal of applied microeconomics. In December 1985, I received the John Bates Clark Award of the American Economic Association, awarded every other year for the most "significant contributions to economics" by an economist under the age of 40. In 1980, I was awarded the Frisch Medal of the Econometric Society. I have been a member of numerous government advisory committees for both the U.S. government and the Commonwealth of Massachusetts. I have published over 130 academic research papers in leading economic journals including the *American Economic Review*, *Econometrica*, and the *Rand (Bell) Journal of Economics*. I recently published a paper on the effects of

regulation on railroads: "Regulating the U.S. Railroads: The Effects of Sunk Costs and Asymmetric Risk," *Journal of Regulatory Economics*, 2002. My curriculum vitae is attached as Exhibit A.

3. I have submitted declarations to the Board previously. These declarations evaluated the economic effects of the UP/SP merger, the economic principles of dominant carrier regulation, and an economic analysis of conditions that arise in mergers of large railroads.¹ I have extensive experience evaluating the effects of mergers. I have published numerous academic papers discussing the evaluation of the effects of mergers and consulted on over 100 mergers before regulatory agencies including the DOJ, FTC, FCC and numerous foreign countries including the EU, UK, Germany, and Australia.

I. Introduction and Summary of Conclusions

4. I am providing this statement at the request of Union Pacific Railroad Company (UP) in connection with the Surface Transportation Board's review of the proposed acquisition of control of the Texas Mexican Railway Company (Tex Mex) and TFM, S.A. de C.V. (TFM) by Kansas City Southern (KCS).

5. In my economic analysis of the proposed transaction I will use prices charged to shippers and the quality of service to shippers who serve as consumers of railroad services as the basis for my evaluation. If prices to shippers decrease, a transaction is typically pro-competitive. To the contrary, if prices to shippers increase (or if service levels decline) the transaction is typically anticompetitive. I do not consider the

¹ See Statement of Jerry Hausman submitted in STB Ex Parte, No. 582 Public Views on Major Rail Consolidations; Verified Statement of Prof. Jerry Hausman, submitted in *Union Pac. Corp., et al. – Control – So. Pac. R. Corp., et al. – Houston/Gulf Coast Oversight*, STB Finance Docket, No. 32760 (Sub-No 26).

effects of the transaction on KCS, nor do I consider the effects of the transaction on competitors to KCS, including UP, except as the transaction affects prices (and service levels) provided to shippers.

6. My economic analysis leads to the following conclusions:
 - A. A significant amount of traffic goes through the Laredo gateway. TFM is the only Mexican railroad that connects to the Laredo gateway. TFM has significant market power for many transportation markets that use the Laredo gateway. TFM's ability to exercise that power today is limited by several factors, one of which is Mexican regulations requiring that TFM offer non-discriminatory pricing between the border and points in Mexico.
 - B. KCS control of Tex Mex and TFM will have significant anticompetitive effects in the United States and on U.S.-Mexico cross-border commerce for at least two reasons. (1) NAFTA Rail will have the incentive and ability to raise the costs and decrease service levels of competing carriers that interchange with TFM, thereby shifting traffic to less-efficient routes and allowing anticompetitive increases in rates and/or reductions in service quality for U.S. shippers. (2) The transaction may produce higher prices to certain U.S. shippers through evasion of the Mexican regulatory provisions prohibiting price discrimination.
 - C. In its application KCS has not claimed the presence of any significant efficiencies. Thus, efficiencies will not offset the anticompetitive effects that arise in this transaction.

D. UP's proposed remedies are appropriate for the transaction. The possible remedial approach that UP's Mr. Gray outlines would not be unduly regulatory or interfere with Applicant's ability to compete with other railroads. It also would not lead to decreased competition because of the possibility of increased coordinated interaction among the competing railroads. The approach is similar to a pro-competitive arrangement that the Board has previously approved in the UP/SP merger.

II. Economic Basis for Evaluation of the Transaction

7. Economists judge transactions depending on whether they have pro-competitive or anticompetitive effects. In judging competitive outcomes, we typically consider the effects on consumers. Transactions can affect many economic agents: consumers, merging firms, competing firms, shareholders in these firms, and debt holders in these firms. Often a transaction will favorably affect some groups and disadvantage other groups. However, the DOJ and FTC have determined that consumer welfare should be the objective in evaluating transactions.² I agree with this approach. Consumers are harmed when prices increase or product quality decreases. Thus, while a transaction may lead to more efficient and lower cost production, the relevant question is whether consumers will benefit from lower prices.³ I discuss this viewpoint in my paper, "Efficiencies from the Consumer Viewpoint," *George Mason Law Review* 7 (1999). In the current situation I will use prices charged to shippers and the quality of service to

² See, e.g., U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (*Merger Guidelines*), 1992, ¶ 0.1.

³ I focus on the price effect of mergers here. Higher quality is similar to a lower price from an economic analysis viewpoint.

shippers who serve as consumers of railroad services to evaluate competitive effects. Typically, if prices to shippers increase, final consumers will pay higher prices for products they purchase.

8. If prices to shippers decrease, a transaction is typically pro-competitive. To the contrary, if prices to shippers increase (or if service levels decline) the transaction is typically anticompetitive. This reasoning holds in the more common situation of horizontal mergers, or in the current situation of a vertical transaction. Thus, I do not consider the effects of the transaction on the KCS, nor do I consider the effects of the transaction on competitors to the KCS, including UP, except as the transaction affects prices (and service levels) provided to shippers.⁴

III. Framework for Economic Analysis

9. I perform my economic analysis within the framework of origin-destination (O-D) markets for a given type of commodity. A shipper will want to ship a commodity from an U.S. origin to a Mexican destination (or vice versa).⁵ The shipper typically chooses from a set of alternatives that includes competing railroads that can transport the commodity as well as alternative modes of transportation to the extent they are available - most often trucks and sometimes barges depending on the commodity. The shipper will make the best choice that combines price, shipping time, other service

⁴ Only in the case of a failing firm (or division) does merger analysis typically consider financial effects on merging firms, *e.g. Merger Guidelines*, ¶ 5.1-5.2. KCS has made no claims regarding a possible failure of the merging firms.

⁵ Thus, my analytical approach differs markedly from Applicants' approach, which does not consider O-D markets. *See Applicants' Supplement* pp. 13-19. Instead, it only considers all US-Mexican freight traffic. This approach does not make economic sense because it obscures important competitive differences among different O-D markets.

attributes, and other economic characteristics, such as variability in shipping time, presence of schedules, and possible damage to shipments. O-D markets typically comprise antitrust markets because if all carriers that serve the O-D pair joined together as a “hypothetical monopolist,” they could increase prices by at least a “small but significant and nontransitory” amount.⁶

10. The proposed transaction would combine control of one Mexican carrier, TFM, with one of the two U.S. railroads, KCS/Tex Mex (KCS), that interchange traffic with TFM at the U.S.-Mexican border. TFM is the only Mexican carrier that serves the Laredo gateway between the U.S. and Mexico. A substantial proportion of traffic transits the Laredo gateway, approximately 75% of all US-Mexican rail traffic (by value), and (as noted below) much higher shares for many O-D markets.

11. While intermodal competition exists for some movements of some commodities, mainly from trucks, TFM routes via the Laredo gateway have significant cost and service advantages over these other transportation alternatives for many O-D pairs for given commodities. TFM routes have similar advantages over other Mexican gateways, such as Eagle Pass, which TFM does not control. Overall, TFM controls the majority of traffic entering Mexico and has even higher shares of traffic that uses the gateways in eastern Mexico. *See Gray V.S. pp. 10-12.*

12. For numerous O-D pairs for given commodities, the alternative gateways are at a significant cost, distance, and service disadvantage, and rail service via the

⁶ *See Merger Guidelines* ¶ 1.2. The geographic market definition can expand if competition exists from other origins that limits the ability of the hypothetical monopolist to increase prices. Given the position of the TFM, as I explain below, this consideration is not important in the current transaction.

alternative gateways thus does not effectively constrain the price that TFM can charge. Thus, for many O-D pairs for given commodities, TFM has significant market power. For example, Eagle Pass, an alternative gateway, lacks many of the infrastructure advantages that make Laredo a highly efficient border crossing point.⁷ Eagle Pass also has limited capacity. My empirical analysis, attached as Exhibit B, demonstrates that for UP southbound traffic an extremely high share of the traffic to important Mexican destinations uses the Laredo gateway, consistent with TFM having significant market power.⁸ For example, { } originates the most southbound traffic, and three of the largest destination states in Mexico are the { }. Note that over { }% of this O-D traffic uses the Laredo gateway with only very small amounts going over the Eagle Pass gateway. For { }, which originates the second most southbound traffic, over { }% of that traffic to the three largest Mexican destination states uses the Laredo gateway. These shipment data demonstrate the importance of the Laredo gateway and the non-economical alternative that the Eagle Pass gateway yields for this traffic.⁹

⁷ See Gray V.S. pp. 13-16, for a further discussion of the competitive advantages of the Laredo gateway.

⁸ A map showing these Mexican destination states and the TFM and FXE route networks is attached as Exhibit C. I limit the analysis to UP data because the data that KCS and BNSF produced in discovery do not indicate the Mexican destinations, so I could not analyze O-D markets. UP's data include destinations within Mexico based on customs information, but that information is only available for southbound shipments.

⁹ UP has an economic incentive to use Eagle Pass since it has a 26% ownership interest in FXE, the Mexican railroad that connects at the Eagle Pass gateway.

13. In the current (pre-transaction) situation KCS owns a significant minority stake in TFM.¹⁰ However, TFM is controlled by Grupo TMM. Under Mexican law, TFM faces no effective constraints imposed by maximum rate regulation. However, under Mexican law and the terms of TFM's Concession, TFM must provide non-discriminatory pricing between the border and points in Mexico it serves (or points where it connects with other Mexican carriers, such as Ferrosur), as KCS emphasizes in its application.¹¹ In addition, under TMM control, TFM has significant economic incentives to cooperate closely with competing U.S. railroads that connect at Laredo. By cooperating with competing railroads at Laredo, the U.S. component of the cost of a rail shipment between a U.S. location and a Mexican location is minimized. Thus, this cooperation keeps the U.S. component of US-Mexican traffic at a minimum price and allows rail traffic to increase through Laredo, providing greater feed to the TFM along with higher revenues and higher profits. Indeed, I understand that TFM has cooperated closely with UP in terms of service levels and price quotes.¹² Further, as Mr. Gray points out, traffic through the Laredo gateway has expanded greatly, largely because of NAFTA and the improved service provided by TFM on the Mexican segment of the traffic.

¹⁰ KCS currently has a 49% voting interest in TFM. Because the Mexican government holds a substantial block of shares without voting rights, KCS's direct economic interest in TFM is 36.9%.

¹¹ See Applicants' Supplement p. 30; *see also* Memorandum of Kuri Brena et. al. submitted by Applicants, June 19, 2003: "Section 2.15 of the TFM Concession specifically restricts TFM from promoting tie-in or tie-out sales, price discrimination and cross subsidies".

¹² See Gray V.S. p. 22.

IV. The Proposed Transaction Will Have Anticompetitive Effects

14. KCS control of Tex Mex and TFM will have anticompetitive effects in the United States for at least two reasons. First, NAFTA Rail will have the incentive and ability to raise the costs and decrease the service levels of competing carriers that interchange with TFM at Laredo, thereby allowing an anticompetitive rate increase in rates or reduction in service levels relating to existing competitive rate levels. Second, the transaction creates the potential for higher prices to certain relatively inelastic shippers through evasion of the Mexican regulatory provisions prohibiting price discrimination. These effects will be felt in the United States, because that is where competition between the carriers north of the border occurs. Because the cooperation of TFM is essential to that competition, control of TFM by one of the two competing U.S. carriers will adversely affect competition for cross-border U.S.-Mexico traffic.

A. Anticompetitive Strategies to Disable UP Competition

15. As a result of the transaction, NAFTA Rail will be able to implement strategies aimed at increasing the costs (and degrading the service quality) of competing carriers that connect with TFM. Those carriers, primarily UP, will then be forced to raise rates, thereby allowing NAFTA Rail to match the increase for shippers who are relatively less price elastic.

16. Shippers currently use UP and KCS/Tex Mex (and its connections, including BNSF) as competitive options for rail movements via Laredo to serve destinations in Mexico. For many O-D markets, as I discussed above, the Laredo gateway is the economical choice. Neither other U.S.-Mexican gateways nor intermodal competition significantly constrains a "hypothetical monopolist" from increasing prices. Thus, economic analysis should focus on these individual O-D markets using Laredo.

Because KCS will control the Laredo gateway if the transaction occurs, NAFTA Rail can increase prices for less-price-elastic shippers using the gateway by disadvantaging UP for shipments that are dependent economically on the use of the Laredo gateway.

17. Currently, TFM has an economic incentive to cooperate fully with all three competing railroads to maximize traffic utilizing the Laredo gateway. The greater the U.S. competition, the higher the service quality and the lower the price for the U.S. segments of a rail movement. Thus, TFM seeks to foster the greatest degree of competition among the U.S. railroads. Conversely, for price-elastic shippers, a deterioration in service or increase in price by TFM would cause some number of the more-price-elastic shippers to send their traffic over other gateways or shift to an alternative transportation mode.

18. However, subsequent to the transaction, the economic incentives for TFM will change. KCS/Tex Mex potentially serves a significant proportion of the UP traffic via Laredo, as I discuss in the next section. To the extent that KCS/TFM can increase the TFM rate factors that are part of the overall price shippers must pay for UP-TFM options, or create a lower level of service quality for UP shipments through the Laredo Gateway, some shippers will choose to shift their traffic from UP to KCS.¹³ KCS will increase the profit from its U.S. operations because price exceeds the marginal cost of the additional traffic, given the high level of fixed costs in the railroad industry.

¹³ The specific means by which NAFTA Rail could facilitate those shifts are explained in the verified statement of John Gray, pp. 26-31. Note that this strategy is distinct from the "raising rivals costs" literature where imposing a cost increase on your competition creates additional costs for the dominant firm. Here no additional costs occur for NAFTA Rail.

19. This strategy will not merely shift incremental margins (profits) from UP to KCS: it will also decrease competition and harm shippers. If UP service levels decrease or its costs increase, competition will decrease and KCS will be able to charge higher prices than currently to less-price-elastic shippers, even though its services were not preferred in the pre-merger environment. That is because UP would have to increase its prices in response to an increase in costs.¹⁴ Thus, less-price-elastic shippers will pay higher prices for the current competition among the U.S. railroads. At the same time, KCS can give rebates (or not charge higher prices) to relatively more-price-elastic shippers who would choose other options if their prices increase. However, for relatively less elastic shippers, KCS will be able to charge a higher price because these shippers do not have alternatives that are closely competitive to shipping via Laredo to many certain Mexican destinations. The anticompetitive result from the transaction is harm to these relatively less elastic shippers.

B. Increases in U.S.-Mexico Rates Through Evasion of Mexican Non-discrimination Regulation

20. Mexican law prohibits TFM from discriminating among customers or among the competing U.S. railroad carriers it connects with at Laredo. Thus, while Mexican railroads face no binding maximum rate regulation, the prohibition on price discrimination today limits the exercise of TFM's market power in connection with U.S.-Mexico cross-border shipments to the extent TFM charges the same price for similar movements to and from Laredo for similar commodities. Shippers who are relatively

¹⁴ The strategy thus has similarities to the price discrimination strategy discussed next. KCS only increases prices to less-price-elastic customers, which is similar to increasing all prices and giving rebates to the relatively price-elastic customers.

price elastic, because they have other rail options through alternative gateways or have better intermodal options, constrain the price that TFM can charge to some degree. Today, if TFM attempted to increase the price it charges between Laredo and a given Mexican destination, the increased revenues from less-price-elastic customers, who would continue shipping on the TFM, would be more than offset by revenue losses from relatively more-price-elastic customers who switch to alternative transportation modes.¹⁵ Thus, although TFM would typically try to set the highest price it could to maximize its profits (but could not do so perfectly in light of incomplete information, *etc.*), it does so subject to the constraints limiting its ability to charge different prices for movements between a given point in Mexico and Laredo. These constraints necessarily mean that TFM's prices to less elastic customers are lower than they would be if TFM could price discriminate freely.

21. Competition among U.S. railroads for the traffic north of the Mexican border prevents TFM's connecting carriers from capturing this extra revenue for the less price-elastic customers. If UP attempted to increase prices to less-elastic Mexican traffic on the U.S. segment, BNSF, KCS or another competing railroad would offer a lower price and gain the traffic. Thus, the U.S. component of a given rail movement is set at competitive levels, while the Mexican component for the less price-elastic customers is above the competitive price, given the limited competition that TFM faces south of the

¹⁵ In economic terminology the more price-elastic customers are "marginal" customers while the less price-elastic customers are "infra-marginal" customers. Almost all commodities and services have both types of customers.

border, but below the price that TFM could charge if it were not subject to Mexican non-discrimination rules.

22. The proposed transaction changes this situation. The combination of KCS and TFM will be able to increase rates to the less-price-elastic shippers, *i.e.* those who have relatively fewer competitive options, while still maintaining non-discriminatory rates south of the border. NAFTA Rail will be able to increase prices by “evading” Mexican non-discrimination legislation.¹⁶ The following example demonstrates how this price increase could occur. Consider two shippers of the same commodity at two hypothetical origins in the United States who ship to a single destination that TFM serves (exclusively) in Mexico. Call the shippers A and B, from the origins O1 and O2, and to the Mexican destination D. Both ship via the Laredo gateway. Currently, TFM charges the same rate for its portion of each movement, since both go via Laredo to Mexican destination D. U.S. railroads serving the two origins, O1 and O2, compete with each other for the traffic. However, shippers A and B differ in their competitive alternatives. Shipper A can also ship via an alternative mode (or gateway, *e.g.*, Eagle Pass) for only a slightly higher price than by rail via Laredo.¹⁷ Shipper B has no closely competing options, either via an alternative gateway or via intermodal competition. Thus Shipper A is relatively price elastic compared to Shipper B. Mexican regulation constrains TFM

¹⁶ By “evasion,” I do not refer to illegal conduct. Instead evasion refers to steps that would be possible for a commonly-controlled railroad to take on international shipments because of its U.S. presence that would be impossible for a railroad operating only in Mexico to achieve.

¹⁷ Alternatively, the price could be similar but the quality via Eagle Pass could be slightly lower (*e.g.*, longer shipping time).

from increasing the price to Shipper B, because it would also be required by law to increase the price to Shipper A, and TFM would then lose Shipper A's traffic.

23. However, if KCS gains control of TFM the result will be an increase in price to shipper B, which means in the O2-to-D market prices will increase, and Shipper B (and others) will suffer competitive harm. Thus, an anticompetitive effect will occur to customers in a well-defined (antitrust) market.

24. I now explain how NAFTA Rail will be able to increase the price to Shipper B in a profitable manner after the transaction takes place. When KCS acquires control it could direct TFM to increase its price from Laredo to Mexican destination D for comparable movements of a given commodity, thereby preventing TFM from explicitly engaging in price discrimination from the border to a Mexican origin. Shipper B, who has no economic alternative, will pay the higher price and will suffer competitive harm from the transaction.

25. So as not to lose business from Shipper A, however, KCS will keep shipper A's overall rate constant by rebating to that shipper an amount that offsets the increased price from Laredo to destination D. This option was not available to TFM before the transaction. If TFM had tried to raise rates on cross-border movements, Shipper A would have chosen another transportation option rather than pay a higher price for shipment from the United States to Mexico. While KCS earns less on the U.S. part of the movement, the amount is exactly offset by the increase on the Mexican part of the movement. Thus, Shipper A pays the same overall through price and continues to ship through Laredo. Further, while NAFTA Rail earns the same overall profits from Shipper A, it earns increased profits from Shipper B, who now pays a higher total price since the

Laredo to destination D price has increased, while the price of the U.S. component of the shipment has remained the same. Thus KCS/TFM, *i.e.* NAFTA Rail, earns higher overall profits. NAFTA Rail has the economic incentive and the ability to increase prices in an anticompetitive manner. Shipper B suffers economic harm from this anticompetitive outcome in a well-defined antitrust market.

26. Rail movements for which trucks may be a competitive alternative would also provide opportunities for the same type of anticompetitive price discrimination. For some shipments, trucks may be a viable competitive option, but only for movements where the U.S. point is relatively close to the border. Thus, those shippers have a choice of using an all-rail option via Laredo (and thereby utilizing TFM), or relying on an all-truck route. Assuming the costs of transloading are significant, a shipper from a more distant U.S. point would be restricted to rail based on distance of haul. Thus, in the face of a price increase by TFM, the second shipper would pay the increased price, while KCS could rebate the increase to the shipper having an intermodal option.

27. A limitation of this strategy is that KCS (or Tex Mex) must serve the various “shipper A’s” (representing the high-elasticity traffic) so that it can provide the rebate after TFM increases its overall price from Laredo to the Mexican destination. KCS need not serve all such high-elasticity shippers. So long as it serves some of them, prices will increase. The amount of high-elasticity shippers that KCS serves will determine by how much prices will increase, but not the fact of the price increase. Also, note that KCS need not serve the less-elastic shippers (shipper B), because they will pay the higher price and no rebate is necessary.

28. I have investigated the amount of overall traffic that UP carries that KCS could also carry to determine whether KCS could carry a sufficiently large percentage to make the price increase significant. My calculations find that currently approximately 50% of the total traffic via Laredo is directly competitive for KCS using its own facilities. Including interline movements with or trackage rights over BNSF, approximately 75% of existing UP traffic could be served by KCS.¹⁸ See Exhibit J to Gray V.S. Thus, the amount of traffic on which KCS could employ the rebate strategy (*i.e.* Shipper A in the hypothetical) is considerably more than needed to make the strategy profitable.

29. One further economic consideration arises in considering the transaction. Mexican regulation also stops TFM from decreasing price to even more price-elastic customers who currently use an alternative gateway or another transportation mode. If TFM decreased prices to these shippers, it would need to decrease prices to all shippers, which would not be a profitable strategy. However, conditions aimed at preventing anticompetitive price increases need not interfere with these beneficial price reductions. In the proposed conditions that I discuss subsequently, TFM could offer lower prices to these shippers who would benefit from the transaction, while not increasing prices to Shipper B.

C. The Overall Anticompetitive Effect is Greater Because of Interaction

30. The two strategies that I have discussed, disabling of UP competition and evasion of Mexican regulation, reinforce each other and enhance the overall

¹⁸ It would be incorrect to use the current amount of traffic carried by KCS, UP, and BNSF to make this calculation because currently shippers pay the same price for the Laredo to Mexico component, regardless of which U.S. shipper they use. After the transaction, this situation would change because of the rebate strategy.

anticompetitive effect. Although the two are not interdependent, *i.e.*, either strategy could be implemented and result in anticompetitive harm on its own, the combined ability to increase its rival's costs and to price discriminate without explicitly varying TFM rates to comparably situated shippers increases NAFTA Rail's harms to shippers.

31. Absent the ability to price discriminate, the strategy of disabling UP competition would be less economically attractive because the NAFTA railway would lose traffic when KCS increases its prices. However, the ability of KCS to provide rebates to relatively more elastic shippers increases the return from this strategy because the traffic lost from the price increase can be limited.

32. Similarly, the ability of TFM to extract profits through price discrimination (made possible by using KCS to circumvent Mexican regulation) increases because of the decreased competition from UP. As KCS gains more traffic because of the decreased service levels of UP, NAFTA Rail is able to provide rebates to a larger group of customers, thus making the price discrimination strategy more effective. TFM will be able to increase prices by more than it would in the absence of the ability to disadvantage UP-bound traffic. Thus, the interaction of the two anticompetitive strategies reinforce each other and leads to a larger anticompetitive effect than the sum of the two strategies acting in isolation.

33. UP can divert some of its traffic to other gateways, *e.g.*, Eagle Pass, to avoid the decreased service levels at Laredo. However, this traffic diversion will lead to higher costs and prices and decreased service levels for shippers. Otherwise, if no difference existed for a given O-D movement through Laredo or Eagle Pass, UP would

already be using Eagle Pass.¹⁹ The additional costs incurred from such diversions decreases economic efficiency, without any corresponding increase in production. Shippers will end up paying higher prices and receiving decreased service levels on this diverted traffic. The result is anticompetitive.

34. TFM, in cooperation with the U.S. railroads, has already achieved efficiencies at Laredo. Shippers have demonstrated the high level of efficiencies by choosing to use Laredo as their Mexican gateway. Further, the high level of efficiencies between UP and TFM cannot be re-created with other railroads because no economical replacement exists for either Laredo or TFM for many O-D markets.

V. Efficiencies Will Not Offset the Anticompetitive Effects of the Transaction

35. Efficiencies can sometimes offset anticompetitive effects that arise in a transaction. If cost saving efficiencies are large enough, they can lead to overall decreases in prices, as I discuss in my previous research.²⁰ The cost savings typically need to be cost savings in variable (marginal) costs to have a decreasing effect on price. Cost savings in overhead and other types of fixed costs typically do not lead to lower prices.

36. In the proposed acquisition neither KCS nor its economist, Professor Grimm, has claimed that any savings will occur, either variable cost savings or fixed cost savings. KCS has explained that the proposed transactions will not achieve any

¹⁹ UP owns a 26% share in FXE, which is the Mexican railroad that connects at Eagle Pass.

²⁰ See J. Hausman, "Competitive Analysis with Differentiated Products," *Annales, D'Economie et de Statistique* 34 (1994); "Economic Analysis of Differentiated Products Mergers Using Real World Data," *George Mason Law Review* 5 (1997), and "Efficiencies from the Consumer Viewpoint," *George Mason Law Review* 7 (1999). The *Merger Guidelines* also discuss the role of efficiencies in Section 4.

operational or service improvements that are not already available through existing cooperation among KCS, Tex Mex, and TFM. KCS, Tex Mex, and TFM already have exceptionally close working relationships and offer what they describe as “seamless service” for traffic moving between the United States and Mexico. They do not anticipate that the NAFTA Rail transaction will allow them to obtain any operational benefits that they are not already pursuing without common control.

37. Some of the public statements by KCS regarding the proposed transaction indicate that efficiencies have already been realized:

- More than a year ago, KCS reported that the “NAFTA Railway Alliance partners KCS, Tex Mex and TFM had “developed a seamless, one-stop customer service approach for moving traffic in and out of Mexico on the NAFTA Railway.” KCS explained that “[e]ach week, the team covers service performance related to KCS’ new pre-blocking plan for traffic going southbound into Mexico, despacho previo and clearances that will help expedite traffic.” KCS also reported that the partners were working on an initiative “to create a similar plan for operational efficiency going northbound, to include the possibility of TFM pre-blocking traffic to save handling and transit time on traffic moving from Mexico to U.S. Markets.”²¹
- KCS’s CEO Michael R. Haverty reported in December 2002 that, even without common control, KCS’s “working relationship with TFM has become very close in 2002, and we expect to further strengthen and build this relationship in 2003.”²²
- The KCS-Tex Mex Control Application reported that, earlier this year, “KCSR, Tex Mex and TFM implemented a plan to pre-block trains moving to and from Mexico.”²³

²¹ KCS NEWS, “NAFTA Railway Partners Reflect and Pursue New Opportunities,” July 9, 2002 (available on www.kcsi.com).

²² KCS NEWS, “*State of the Railroad: From the Desk of Michael R. Haverty, Chairman, President and CEO*,” Dec. 17, 2002 (available on www.kcsi.com).

²³ KCS Application, Riney V.S. p. 136.

38. Thus, with no offsetting efficiency effects for the anticompetitive price increases that I discussed earlier, the net result will be price increases in antitrust markets that injure shippers and consumers. Even if there were cost savings, however, the conditions needed to prevent anticompetitive conduct need not interfere with them. The Applicants have claimed that UP and others “do not seem to understand that KCS’s transaction with TFM is an acquisition of control, not a merger.”²⁴ The anticompetitive strategies outlined above only require common control, not a full integration of operations. In fact, an outright merger might be preferable from an economics standpoint because it might produce cost savings from reduced overhead. In any event, the continued separate corporate existence of TFM is immaterial to the above analysis, so long as TFM and KCS share a common economic interest in maximizing overall profit, which common control will provide.

VI. Applicants Incorrectly Analyze the Competitive Effects of the Transaction

39. Professor Grimm attempts to analyze the transaction solely on a horizontal basis.²⁵ His approach is incorrect. The transaction is vertical, not horizontal, since KCS and TFM do not compete for traffic. Instead, TFM is either the upstream or downstream provider of rail transportation from Laredo to Mexican destinations and has market power as the only Mexican railroad serving Laredo. Based on a purely horizontal analysis, I agree with Professor Grimm that no problems arise because no 2-to-1 (or other)

²⁴ KCS Reply to Petition of CN to Reopen Decision No. 2 and to Reject Application (KCS-16), July 21, 2003, p. 19.

²⁵ Grimm Supplemental V.S. pp. 2-4: “The main body of my initial statement examined the horizontal competitive effects from the transaction....The KCS/Tex Mex/TFM transactions are purely end-to-end with no horizontal anticompetitive effects.”

reductions in the number of competing carriers will occur. But the correct analysis is as a vertical merger. While vertical mergers typically do not create the potential for anticompetitive effects in the same way as horizontal mergers, the potential for vertical mergers to lead to anticompetitive outcomes is well recognized, especially when regulation is involved.²⁶

A. Vertical Mergers that Facilitate Disadvantaging Competitors

40. The economics literature recognizes that vertical mergers can produce anticompetitive effects where the merged entity can decrease the service quality or increase costs of its rivals.²⁷ By discriminating against a competitor and causing its service quality to be lower, a firm can increase its own demand and often charge higher prices. For example, prior to the AT&T divestiture, an AT&T long distance customer dialed 10 digits (e.g. 202-368-3543) to make a long distance call while a Sprint or MCI customer typically had to dial a significant amount of extra digits beyond the 10 digits. The extra time and inconvenience of dialing the extra digits decreased Sprint's and MCI's long distance demand. More recently, the U.S. DOJ required a vertical merger party to offer guarantees via a consent decree that it would cooperate with downstream competitors and not degrade the quality of service the combined firm offered to

²⁶ See, e.g., D. Carlton and J. Perloff, *Modern Industrial Organization*, (Reading, MA, 3rd Ed., 2001, p. 386): "Firms may vertically integrate to evade or avoid government price controls, taxes, and regulations." See M. Riordan and S. Salop, "Evaluating Vertical Mergers," *Antitrust Law Journal*, 63, 1995: "A vertical merger also can help a firm to evade statutes or regulations that prohibit price discrimination." (p. 520); see also, A. Kahn, *The Economics of Regulation*, (New York, 1971, vol. II, pp. 296-297).

²⁷ See, e.g., Riordan and Salop, op. cit.

competitors.²⁸ The recent FTC challenge to the acquisition of two interstate natural gas pipelines by a monopoly gas utility in Michigan provides a further example of the potential for anticompetitive behavior through vertical integration.²⁹

B. Vertical Mergers and Regulatory Evasion

41. Regulation attempts to eliminate the exercise of market power, which is defined as the ability to charge prices above the competitive level for a significant period of time. The economics literature recognizes that vertical mergers can lead to the evasion of regulation and to allow the combined firm to better price discriminate.³⁰ For example, prior to the breakup of AT&T, the U.S. government alleged that AT&T evaded regulation on its monopoly local telephone service by charging higher prices on equipment from its unregulated equipment subsidiary, Western Electric.³¹ This regulatory evasion was completely vertical in nature and allegedly led to higher prices to consumers. Similarly, the regulatory evasion by TFM of Mexican regulation will lead to higher prices to relatively less elastic shippers.

²⁸ See *U.S. v. Northrop Grumman & TRW*, 2003-1 TRADE CAS. ¶ 74,057 (D.D.C. 2003).

²⁹ See *CMS Energy Corp.*, No. 991-0046, 64 FED. REG. 14,725 (1999) (Aid to Public Comment). The FTC alleged that the merged entity would restrict access to its solely served customers in Michigan by non-affiliated pipelines, thereby allowing it to increase rates for gas transportation on its affiliated pipelines into Michigan. The anticompetitive service restrictions of concern to the FTC are analogous to the behavior potentially available to NAFTA Rail. The FTC consent decree imposes service conditions to ensure equal access for non-affiliated pipelines.

³⁰ See footnote no. 26 for regulatory evasion. For the ability to price discriminate, see, e.g., M.K. Perry, "Vertical Integration: Determinants and Effects," in *Handbook of Industrial Organization*, eds. R. Schmalensee and R. Willig, Amsterdam: North Holland, 1989.

³¹ *U.S. v. American Tel. & Telegraph*, 552 F.Supp. 131 (D.D.C. 1982).

42. Vertical mergers can also sometimes have anticompetitive horizontal effects related to regulatory evasion. To the extent that TFM can disable UP and BNSF and make them less competitive with KCS, KCS will be able to increase its prices because UP and BNSF will offer inferior service. Again, one illustration of this problem was the U.S. government's allegation that AT&T used its monopoly over local phone service to discriminate against its long distance rivals such as MCI and Sprint, and these actions allowed AT&T to maintain higher long distance prices. AT&T's actions allegedly occurred despite active regulatory oversight by the FCC and state Public Utility Commissions.³² Similarly, the DOJ has challenged vertical mergers between natural gas pipelines and electric utilities that could produce anticompetitive effects.³³ Here no active regulatory oversight occurs at the Laredo gateway, so anticompetitive strategies would be more easily implemented.

C. Potential Diversions Do Not Eliminate Anticompetitive Effects

43. The ability for TFM to implement anticompetitive strategies both at the current time and in the future after the transaction is constrained to some extent by intermodal competition and competition from other gateways.³⁴ But these constraints are already reflected in current prices that limit the amount of market power that TFM can exercise. These competitive constraints will not change with the transaction, so that

³² See *id.*

³³ See, e.g., *United States v. Enova Corp.*, 107 F. Supp. 2d 10 (D.D.C. 2000). In *Enova*, an electric utility was required to divest gas-fired generating plants prior to acquiring a gas utility with monopoly control over a natural gas pipeline into southern California. The competitive concern was that the merged firm would cause higher electric prices by limiting access of its competitors.

³⁴ See Applicants' Supplement pp. 13-19; Davies V.S. pp. 7-13.

prices will increase following the transaction as my analysis demonstrates. Also, UP will have the potential to divert some amount of current UP-TFM traffic to UP-FXE routes, such as by using the Eagle Pass gateway.³⁵ But this traffic diversion will lead to higher costs and prices or lower service quality; otherwise UP would have already implemented this diversion.³⁶ Thus, to the extent that UP is forced to divert traffic to UP-FXE routes by higher prices or by discrimination, the outcome will be anticompetitive.

VII. Previous STB Merger Policy

44. I understand that the Board has traditionally accepted the “one-lump” doctrine in previous merger cases.³⁷ My conclusions about the adverse competitive dangers in this case are not inconsistent with the Board’s past application of the doctrine. The factual circumstances of this situation are different from those at issue in the usual end-to-end merger case.

45. The distinctions arise from the nature of the Laredo Gateway and the competition north of the border that has occurred because of the neutral and non-discriminatory behavior of TFM south of the border. As an international gateway, Laredo presents a different regulatory context than the usual case. TFM’s existing rate levels are subject to different regulation than a domestic gateway in the U.S. In the U.S., dominant carrier regulation remains in place both before and after a merger. Further, in the U.S., where vertical mergers have combined railroads on both sides of major

³⁵ See Applicants’ Supplement pp. 21-24; Davies V.S. pp. 13-14.

³⁶ UP has an economic incentive to use FXE given its 26% ownership interest in FXE.

³⁷ See *Erie-Niagara Steering Committee v. Surface Transportation Board*, 247 F.3d 437, 443 (2d Cir. 2001).

gateways, there typically have been several independent routes for given O-D markets, which limits the ability of the merging railroads to exercise significant market power. Past mergers that formed new single-line routes thus caused other railroads to form similar pairings using the same major gateways (*e.g.*, at Cincinnati, where separate end-to-end mergers formed the CSX and Norfolk Southern systems, both of which operate on both sides of the former-gateway). In the current situation, the traffic data that I discussed above demonstrate the importance of the Laredo Gateway, and only TFM provides rail service on the Mexican side of the Laredo Gateway. Indeed, the Board has recognized that, in an age of declining opportunities to form alternative connections at gateways, it is necessary to impose conditions to keep major existing gateways open.³⁸

VIII. The Remedies that UP has Proposed are Appropriate

46. KCS has offered commitments not to engage in anticompetitive strategies.³⁹ Economists typically believe that firms will engage in anticompetitive activities to increase profits so long as the firms' actions are not illegal. Indeed, many influential management textbooks discuss at length the use of business strategies to disable competitors to increase profits. Thus, most economists are extremely hesitant to take the "word" of merging firms that they will not increase prices after a transaction if they have the ability to do so given the economic incentives to do so. Thus it is important that KCS's commitments be made enforceable.

³⁸ See *Major Rail Consolidation Procedures*, STB Ex Parte 582 (Sub-No. 1) (STB served June 11, 2001) at 25.

³⁹ See, *e.g.*, Applicants' Supplement p. 4, p. 25, p. 26, Davies V.S. pp. 14-16.

47. As Mr. Gray describes, the Board could require KCS to implement its commitments in an effective and enforceable way without posing any risks or hampering competition. Three criteria are relevant in considering proposed regulatory remedies: (1) remedies should be workable and not unduly regulatory; (2) remedies should be designed to affect only the potential adverse consequences; and (3) remedies should not interfere with the Applicants' ability to compete more effectively against other railroads and transportation modes by exploiting possible pro-competitive benefits of the transaction. UP's proposed remedies satisfy each of these criteria.

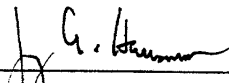
48. UP has proposed that KCS, as a condition for approval, be required to negotiate an agreement to implement its vague commitment to "keep the Laredo gateway open on commercially reasonable terms." UP has also suggested that one appropriate way that the commitment might be made concrete and enforceable is via a "proportional rate matrix approach" that would attempt to limit anticompetitive price increases by TFM following the transaction. Such an approach would be consistent with the remedial principles described above and has been successfully employed in the "I-5 Proportional Rate Agreement" between UP and BNSF, which the Board approved as part of the UP/SP merger. The agreement would only apply to traffic interchanged between UP and TFM at Laredo so it would not restrict NAFTA Rail's ability to compete for traffic using KCS-Tex Mex routes north of the border. Further, it does not create an increased opportunity for coordinated interaction among the railroads since they gain no knowledge of their competitor's prices. But the proportional rate matrix approach does cause TFM on average to offer UP similar rates to what it "charges itself." The approach is similar to the "imputation approach" used in telecommunications regulation in the similar situation

of a monopoly provider competing in other non-regulated markets.⁴⁰ Thus, if NAFTA Rail is more efficient in a given O-D market for a commodity, the proposed regulation will not hinder NAFTA Rail from winning the movement away from UP.

⁴⁰ I discuss the pro-competitive aspects of imputation in J. Hausman, "Efficient Local Exchange Competition," *Antitrust Bulletin*, 1995

I, Jerry A. Hausman, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on August 1, 2003.



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 Associate Editor, Journal of Public Economics, 1982-1998
 Associate Editor, Journal of Applied Econometrics, 1985-1993
 Advisory Editor, Economics Research Network and Social Science Research, 1998-
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 Special Witness (Master) for the Honorable John R. Bartels, U.S. District Court for the Eastern District of New York in Carter vs. Newsday, Inc., 1981-82
 Member of Governor's Advisory Council (Massachusetts) for Revenue and Taxation, 1984-1992
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 Director, MIT Telecommunications Economics Research Program, 1988-
 Board of Directors, Theseus Institute, France Telecom University, 1988-1995
 Member, Conference on Income and Wealth, National Bureau of Economic Research, 1992-
 Member, Committee on the Future of Boston, 1998
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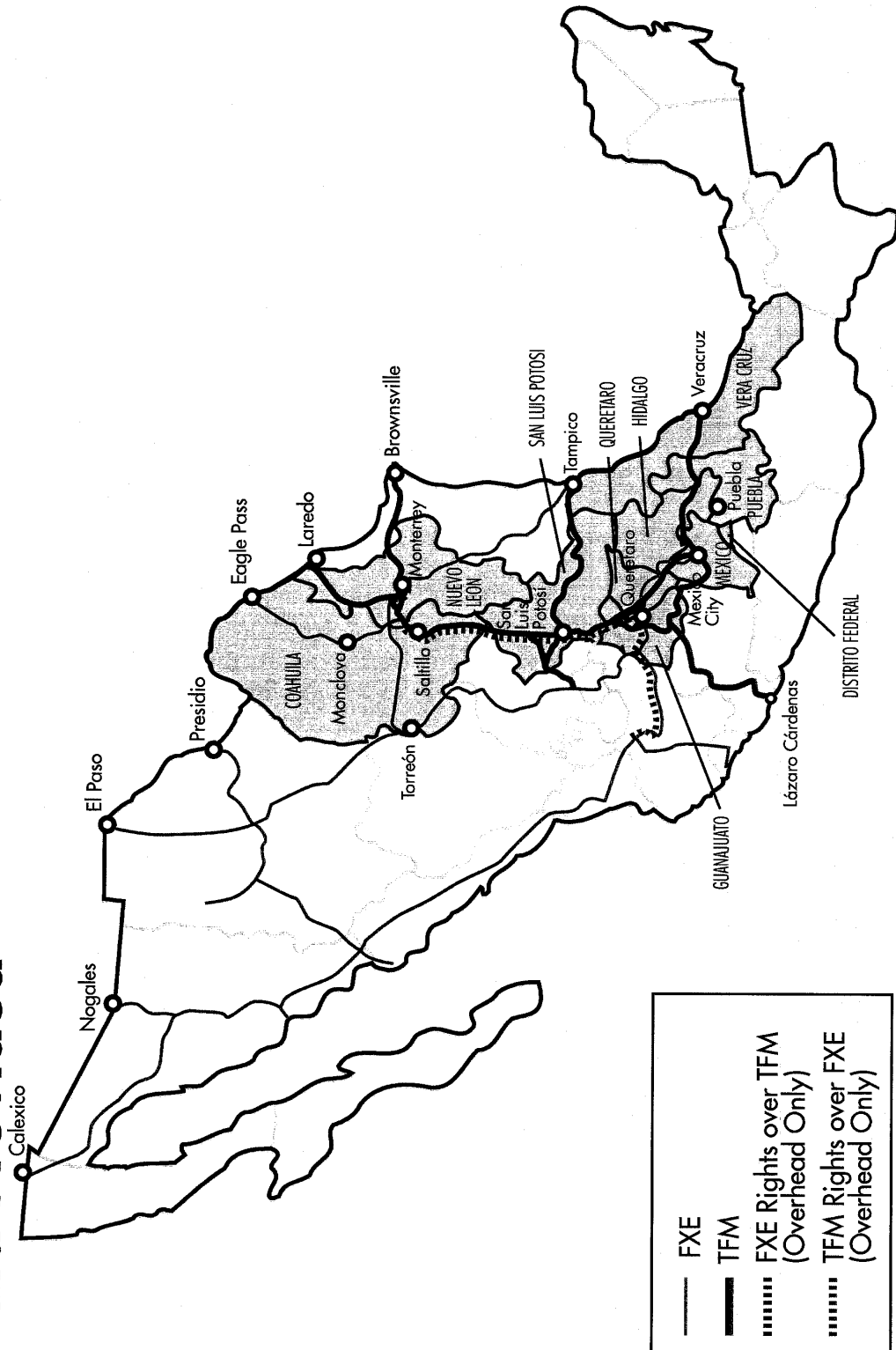
Hausman Exhibit B
Public

Share of State-to-State Traffic To Mexico Moving Via Laredo Gateway
(2001 UP Southbound Movements)

Redacted

Key Mexican States for Which TFM/Laredo Share Data Provided

Hausman Exhibit C
Public



Fuentes

**VERIFIED STATEMENT
OF
FRANCISCO FUENTES OSTOS**

My name is Francisco Fuentes Ostos. I have been a partner in the Mexican law firm of Mijares, Angoitia, Cortés y Fuentes, S.C. since the firm's inception in 1994. I was admitted to practice in Mexico (Escuela Libre de Derecho) in 1990 and obtained a Masters of Law degree from Cambridge University, UK in 1992. I have regularly advised clients on competition issues in Mexico since Mexico's antitrust laws were enacted in 1993. Our firm acted as legal counsel to the financial advisor appointed by the Mexican Federal Government in 1996 for the privatization of the railroad companies, and since then has advised clients on legal issues related to railroad transportation services.

I have acted as the principal competition counsel to the Union Pacific Railroad Company ("UP") with respect to the Mexican issues raised by the proposed acquisition of control by Kansas City Southern ("KCS") of TFM, S.A. de C.V. ("TFM").

UP has asked me to discuss how Mexican law and regulation governing railroads relate to the KCS-TFM transaction. In Section I of this statement, I explain that Mexican law and regulation could not be expected to prevent KCS control of TFM from having adverse effects on competition in the United States for U.S.-Mexico cross-border rail shipments. I note that some of the potential anticompetitive conduct that concerns UP is simply beyond the reach of Mexican law and regulation. I also discuss the fact that the regulatory authorities and courts in Mexico have not implemented the pertinent Mexican railroad regulations, and that it is highly unlikely that a dispute concerning TFM's future compliance with Mexican regulatory requirements could be resolved in an efficient manner.

And I explain how Mexican legal and regulatory processes have for several years allowed TFM to block steps by Ferrocarril Mexicano, S.A. de C.V. ("Ferromex") to enforce rights that it was entitled to under TFM's Concession and Mexican law. In Section II, I describe the Mexican regulatory approval processes applicable to KCS's acquisition of control of TFM and discuss how the relevant Mexican agencies have approached the proposed merger. In Section III, I explain that action by the U.S. Surface Transportation Board ("STB") to enforce commitments made by KCS relating to U.S.-Mexico international rail traffic would not interfere with Mexican law or sovereignty.

I. MEXICAN LAW CANNOT BE RELIED UPON TO PREVENT ANTICOMPETITIVE EFFECTS ON CROSS-BORDER RAIL TRAFFIC

It would not be reasonable to expect that UP or other parties could effectively prevent potential anticompetitive conduct by KCS/TFM by attempting to enforce provisions of Mexican law or TFM's Concession. It is critically important to realize that Mexico's railroad regulatory regime is still in its infancy, which means that Mexican regulators and courts have had almost no occasion to interpret or enforce these provisions.¹ Thus, there is considerable uncertainty regarding how regulators and courts would respond to a complaint of discriminatory treatment. What is certain, however, is that a dispute that raises novel issues of discrimination would likely take years to resolve.

¹ Before 1996, the Mexican state owned all railroad assets in the country. In 1995, the Congress amended the constitution in order to allow for private ownership, and then passed a privatization statute. Over the next several years, the various railroad concessions were auctioned off to private investors, with the last sale taking place in 1999.

A. Mexican Law and Regulations Would Not Prevent Across-the Board Increases in TFM Rates

Some of the anticompetitive conduct discussed in UP's Comments is not addressed at all by Mexican railroad law. If the combined KCS/Tex Mex/TFM entity were to engage in the sort of conduct described by Professor Hausman in his verified statement, which would involve TFM raising its rates between Laredo and TFM-served origins and destinations on a non-discriminatory basis (i.e., across-the-board), with KCS selectively granting rebates by lowering its portion of the overall rate on U.S.-Mexico traffic, such conduct would probably not be reviewable under Mexican law.

By statute, there are no practical limits on how high TFM could raise its rates within Mexico. Article 170 of the Railroad Regulations provides that carriers may freely set their rates.² Carriers must file their maximum rates with the SCT for each of their routes, and once a maximum rate is registered, the carrier cannot charge more than that rate. There is no limitation, however, on a carrier's ability to return to the SCT and file a higher rate whenever it chooses.

Although rates are freely set by the concession holders, the Authorizing Statute and its regulations contain a procedure through which certain parties can challenge a carrier's registered rates upon having a ruling from the Federal Competition Commission ("CFC") that effective competition does not exist. *See* Authorizing Statute, Article 47; Regulation, Articles 171-73. No rate has ever been challenged pursuant to these provisions.

² The Regulations were issued in 1996 by the Secretary of Communications and Transport (SCT) pursuant to the terms of the Rail Service Authorizing Statute (*Ley Reglamentaria Del Servicio Ferroviario*) ("Authorizing Statute") that Congress passed as part of the privatization of the Mexican railroad system.

As discussed below, there are numerous questions about how this procedure would be applied.

Mexican authorities likely would have no say about the overall TFM-Tex Mex-KCS rate if the *TFM portion of the rate* was offered in a nondiscriminatory manner to all shippers under equal conditions. Mexican railroad law and TFM's Concession³ contain various provisions that purport to require TFM to set rates in a non-discriminatory manner. Under Article 170, a carrier's maximum rates "shall be applied in a non-discriminatory manner and shall be the same for users in equal conditions." Carriers are permitted to charge less than their maximum rates as long as they grant such discounts to "users in equal circumstances, in a fair and non-discriminatory manner, in accordance with the specific characteristics of each service, according to the classifications established by this in keeping with the present Regulations."

The TFM Concession also includes several provisions regarding non-discriminatory behavior. Section 2.1 states that TFM "is obligated to provide rail services to requesting users in a permanent and uniform manner and under equitable and nondiscriminatory conditions with respect to opportunity, quality and price, according to the terms laid out in Chapter VII, title three, of the Regulation. Section 2.2 of the TFM Concession requires that TFM "provide terminal and interconnection services at all points connecting with the railroads of other concessionaires or with connecting railroads of other countries under fair and non-discriminatory conditions in regard to timeliness, quality and price." Section 2.2 goes on to say that "[a]ny difference in the timeliness of the service or in

³ See Supplement to Application (KCS-10/TM-10), Exh. A.

the rates applied must be based on specific circumstances that justify such distinctions being made.”

An increase in TFM’s rates that was the same for both connections at Laredo, as part of a strategy by KCS/TFM to increase the overall rates on origin-to-destination cross-border shipments, does not appear to be addressed by these provisions.

B. Parties Could Not Rely on the Ability to Enforce Any Provisions of Mexican Railroad Law or TFM’s Concession to Prevent Anticompetitive Discrimination By TFM Resulting from KCS Control

The provisions of Mexican law and TFM’s Concession noted above do address discriminatory behavior by TFM. However, even if these provisions would in theory apply to the anticompetitive strategies described by UP, efforts to enforce them against TFM would not be effective. To my knowledge, the SCT, which is charged with enforcing the Authorizing Statute and the Regulations, has never had occasion to rule on a dispute involving an allegedly discriminatory practice. Thus, there are numerous open questions regarding, *inter alia*, how the SCT would interpret the applicable nondiscrimination provisions, what sort of relief might be ordered, and what actions TFM might take to delay the enforcement of remedial measures. For example, there is no definitive precedent on whether the anti-discrimination provisions would apply to discrimination by TFM between KCS and other U.S. connecting carriers if KCS and TFM were under common control.

Even if UP or another affected party were successful in challenging TFM’s conduct, the process for obtaining a favorable SCT resolution, and then enforcing it against TFM, would involve protracted litigation before multiple administrative agencies and courts in Mexico.

First, the procedures for obtaining a resolution from the SCT can be very time-consuming. Certain types of actions, including challenges to registered maximum rates, require, as mentioned above, that the parties obtain an opinion from the CFC before the SCT will entertain the complaint. For other types of actions, including complaints regarding interconnection services, the parties must first attempt to reach a voluntary agreement within a 90 day period before the SCT will step in. And even then, the parties have the right to challenge in court SCT's decision. Currently the two main railroad companies in Mexico are litigating in federal courts SCT's decision regarding certain trackage rights fees, and that litigation has dragged on for years.

Second, even if UP or another affected party were successful in obtaining a favorable ruling from the SCT, the Mexican legal system would afford TFM various opportunities to challenge the SCT resolution and to block the resolution during the pendency of such challenge. All resolutions issued by administrative agencies such as the SCT are subject to appeal and review by the Mexican courts, and such appeals are typically time-consuming, especially where untested issues of law are involved. Moreover, there are various legal vehicles that TFM could invoke to suspend the effects of the resolution while such appeals are pending. In accordance with the Mexican judicial system, decisions by the SCT could be appealed to the Federal Administrative and Tax Tribunal by TFM and in some instances its decisions could be challenged directly by "*amparo*" proceedings in Federal courts. The writ of "*amparo*" offers federal judicial protection from laws or governmental actions that are asserted to violate individual constitutional rights.

One example of the difficulty in obtaining, and then enforcing, an SCT resolution is the frustrations that Ferromex, a Mexican competitor to TFM, has experienced for six years in seeking to enforce certain provisions of the TFM Concession. As a

condition to the auction of the TFM concession, the SCT sought to ensure competition in the important industrial center of Monterrey by requiring that TFM grant Ferromex access to certain shippers in that city. The fees and conditions associated with this access, however, were not spelled out in TFM Concession. Thus, Ferromex – after failing to reach a voluntary agreement with TFM – sent a letter on July 4, 2001, requesting that the SCT require that TFM make available to Ferromex certain trackage rights and terminal services that are necessary in order to enjoy full access to shippers in Monterrey. Roughly a year later, on August 7, 2002, the SCT issued a resolution granting Ferromex’s request and requiring that TFM grant access under specified terms and conditions. Then, TFM obtained a resolution from the Ninth Court of the Federal Administrative and Tax Tribunal which suspends the SCT’s resolution and prevents Ferromex from exercising the rights granted to it by the SCT. To my knowledge, this suspension remains in effect. In all, there are more than 20 *amparo* proceedings currently in place between TFM and Ferromex. Experience confirms that efforts to enforce TFM’s obligations under its Concession and applicable railroad law and regulations have been ineffective for many years.

II. THE REVIEW OF THE KCS-TFM TRANSACTION BY MEXICAN REGULATORS

The proposed KCS-TFM transaction requires the approval of two Mexican regulatory agencies. The first agency, CFC, approved the transaction without condition in a resolution dated May 19, 2003. KCS produced an English-language translation of the resolution to UP in discovery, which is attached as Exhibit A (“CFC Resolution”). Because the Chairman of the CFC was recused from participating in the proceeding, only four of the

five commissioners voted, and the merger was approved by a vote of 2-2.⁴ UP attempted to participate in the CFC proceeding as an interested party, but the CFC rejected its submissions based on its position that third parties are not permitted to participate in CFC processes.

The CFC resolution defined the relevant geographic market as {“

”} Exh. A, KCS –

C0188. It held that the merger would not affect competition because the merger would not cause the national railroad system to undergo any changes. Exh. A, KCS – C0189. It did not address any of the vertical issues raised by the transaction or any of the effects that the transaction might have in the United States on U.S.-Mexico cross-border traffic.

The other regulatory agency that needs to approve the proposed merger is the Foreign Investment Commission (“FIC”). To my knowledge, the FIC has not yet issued a decision on the transaction. In accordance with the Foreign Investment Law and the Authorizing Statute, FIC will be examining whether the transaction would contribute to increasing the competitiveness of Mexican industry and promoting regional and technological development, and protect the sovereign integrity of the Nation. The primary focus of this inquiry is on internal Mexican economic matters.

Another Mexican agency that is closely involved in evaluating the potential effects of the proposed merger is the Secretary of Communications and Transportation (“SCT”). SCT is the agency charged with regulation of the railroad industry. Although

⁴ The tie-breaking vote was cast by one of the participating Commissioners who had been given tie-breaking authority in the temporary absence of the Chairman. *See* CFC Resolution, Exh. A, KCS – C0189. It is questionable whether such tie-breaking vote temporary authority is valid.

KCS and TFM do not need formal SCT approval in order to consummate the TFM acquisition,⁵ SCT, as a member of FIC, has been closely involved in helping the FIC evaluate the transaction.

One of the points that various interested parties have discussed with SCT and FIC is the desirability of enhancing the ability of the other Mexican railroad serving the U.S. border – Ferromex – to compete more effectively against TFM (and against other modes of transportation, including trucks) within Mexico, including for the portion of international movements between the U.S. border and points served by TFM in Mexico. One approach would require an elimination of restrictions imposed by TFM on Ferromex's use of trackage rights TFM's important mainline between Ramos Arizpe (near Saltillo) and Querétaro, and a reduction in the high level of fees for those rights. The fees TFM charges Ferromex are high principally because the SCT has determined that the costs upon which such fees are based should include the amortization costs of the high purchase price paid for the TFM Concession. My understanding is that KCS and TFM, in negotiations with the relevant agencies, have refused to consider any proposal that would lead to a meaningful reduction in TFM's high fees.

III. REQUIRING TFM TO NOT DISCRIMINATE WITH RESPECT TO INTERNATIONAL TRAFFIC FLOWS WOULD NOT CONFLICT WITH MEXICAN LAW OR OFFEND MEXICAN NOTIONS OF SOVEREIGNTY.

I understand that UP will be asking the STB to impose conditions on the KCS-Tex Mex acquisition that would require KCS to abide by commitments it is making regarding the Laredo Bridge, and also regarding KCS's use of its control over TFM to

⁵ They are required only to file a notice with SCT of the share acquisition by KCS once it is completed.

ensure that TFM continues to work with UP on international cross-border traffic via the Laredo Gateway and continues to provide commercially reasonable rates or rate factors that allow UP-TFM services to remain competitive.

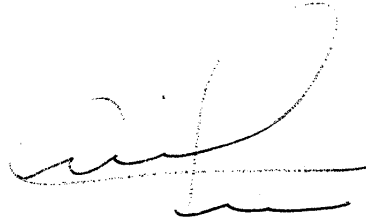
Such action by the STB would not interfere with the role, pursuant to its legal mandate, of any relevant Mexican governmental agency, or involve any conflict or interference with Mexican legal principles, including sovereignty principles. As discussed above in Section II, Mexican railroad law today requires that TFM cooperate with its U.S. connections on an impartial and non-discriminatory basis, including on the rates that it sets and the services it provides, and I understand that TFM has acted in a neutral manner. The commitments KCS has made appear designed to ensure that KCS's control of TFM does not cause an adverse change in the way TFM behaves with respect to its other connections, principally UP, on international traffic flows. Such a commitment is perfectly consistent with Mexican law and regulations.

It would be equally appropriate for the STB to play a role in holding KCS – a U.S. company – to its commitments in an effective way. The Mexican authorities would not question the Board's role in considering and protecting competition for international traffic flows that benefit U.S. customers. As I explained above, no agency of the Mexican government concerns itself with protecting rail competition in the United States that depends on effective cooperation from TFM for the portion of the movement from Laredo south. Steps by the STB that would require KCS to use its new control of TFM to ensure that TFM works with UP on traffic moving across the border at Laredo, and quotes commercially reasonable rates for UP-TFM cross-border interline movements, would not involve any inappropriate interference in internal Mexican affairs or call upon TFM to do anything

inconsistent with other Mexican legal requirements. To the contrary, such steps would be consistent with the principles of non-discrimination and fostering of competition that Mexican law requires Mexican governmental agencies to apply.

I, Francisco Fuentes Ostos, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on August 1, 2003.

A handwritten signature in black ink, appearing to read 'Fuentes Ostos', written over a horizontal line.

Francisco Fuentes Ostos

EXHIBIT FILED UNDER SEAL