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SERVICE DATE - MAY 1, 1997

SURFACE TRANSPORTATION BOARD

DECISION

STB Finance Docket No. 33311

KANSAS CITY SOUTHERN INDUSTRIES, INC., KCS TRANSPORTATION COMPANY, AND THE KANSAS CITY SOUTHERN RAILWAY COMPANY--CONTROL--GATEWAY WESTERN RAILWAY COMPANY AND GATEWAY EASTERN RAILWAY COMPANY

Decided: April 28, 1997

By application filed January 14, 1997, Kansas City Southern Industries, Inc. (KCSI), KCS Transportation Company (KCSTC), The Kansas City Southern Railway Company (KCSR), Gateway Western Railway Company (GWWR), and Gateway Eastern Railway Company (GWER) seek authority under 49 U.S.C. 11323-25 for KCSI to acquire control of GWWR and GWER.[1] On December 12, 1996, KCSI's wholly owned noncarrier subsidiary, KCSTC, acquired the stock of Gateway and placed the shares into an independent voting trust. Upon approval of this application, the voting trust will be dissolved, and the shares will be transferred to KCSTC. Applicants indicate that, after the transaction is effected, KCSI will control KCSR and Gateway.

In a notice served and published on February 13, 1997 (62 FR 6832), we accepted the application and determined that this is a minor transaction as defined in 49 CFR part 1180. We invited comments from interested parties, including the Secretary of Transportation and the Attorney General of the United States, by March 17, 1997. We gave the applicants until April 1, 1997, to reply.

The application includes supporting statements from the following shippers: Alliance Shippers Inc.; Alma Farmers Cooperative Association; Ameripol Synpol Corporation; Archer Daniels Midland Company; Bethlehem Steel Corporation; Boise Cascade Corporation; C-E Minerals; Consolidated Grain and Barge Company; Darling International Inc.; The Dow Chemical Company; Fletcher Grain Company, Inc.; Forest City Trading Group, Inc.; GST Corporation; GST Steel Company; The Heritage Group; Hub Group, Inc.; International Paper Company; Inland Paperboard and Packaging, Inc.; Jefferson Smurfit Corporation; Laclede Steel Corporation; Longview Fibre Company; The Lubrizol Corporation; Mark VII Transportation Co. Inc.; McCann's Piggyback Consolidation, Inc.; MFA Incorporated; Pan Pacific Forest Products, Inc.; Procter & Gamble Manufacturing Company; Quality Intermodal Corp.; Rail Van, Inc.; Schneider National, Inc.; Stone Container Corporation; WECO Trading, Inc.; Westvaco Corporation; and Weyerhauser Company. Supporting statements also have been filed by Conoco Inc.; SFE Shippers Association; and Willamette Industries, Inc. The Allied Rail Unions (ARU),[2] Brotherhood of Maintenance of Way Employes (BWME) and the United Transportation Union-Illinois Legislative Board (UTU-IL)

[1] GWWR and GWER will be collectively referred to as Gateway.

[2] ARU represents the following unions: The American Train Dispatchers Department of the International Brotherhood of Locomotive Engineers; Brotherhood of Locomotive Engineers; Brotherhood of Railroad Signalmen; International Brotherhood of Boilermakers, Iron Ship Builders, Blacksmiths, Forgers & Helpers; International Brotherhood of Electrical Workers; National Council of Firemen and Oilers/SEIU; and Sheet Metal Workers International Association.

(jointly, Rail Labor) request imposition of labor protective conditions.[3] None of the comments raise issues of adverse competitive impact. Applicants have replied.

The Applicants

KCSI is a noncarrier holding company that directly controls KCSR and KCSTC.[4] KCSTC is a noncarrier subsidiary of KCSI that was organized to acquire Gateway's stock. KCSR is a Class I railroad that operates approximately 4,104 route miles of rail lines in nine Midwestern and Southern states.

KCSR's principal routes extend from Kansas City, MO/KS, via Shreveport, LA, to Beaumont/Port Arthur, TX, Lake Charles, LA, and New Orleans, LA. Another route extends between Dallas, TX, and Shreveport, and a branch line extends north out of Alexandria, LA, to Hope, AR. In 1993, KCSR acquired the MidSouth Rail system[5] and added the following routes: between Shreveport and Meridian, MS; between Jackson and Gulfport, MS; between Meridian and Birmingham, AL; and between Corinth, MS, and Middleton, TN, and Meridian. KCSR also provides service, via limited haulage rights, over Union Pacific Railroad Company (UP) lines between Omaha/Council Bluffs, Lincoln, NE, Topeka and Atchison, KS, and Kansas City, MO; and between Beaumont and Houston/Galveston, TX.

KCSR carries grain from the Omaha/Council Bluffs area, Lincoln, NE, and Atchison and Topeka, KS, to animal feed processors located in Arkansas, Texas, Louisiana, and Mississippi, grain export facilities at Beaumont, Port Arthur, Houston, and Galveston, TX, and Baton Rouge, Reserve, and New Orleans, LA. KCSR also is a significant competitor for general freight and intermodal traffic moving into the Southeast. KCSR interchanges with Norfolk Southern Railway at

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[3] UTU-IL claims that the application is deficient because the public version omits the February 28, 1996 agreement between KCSI and Gateway. The applicants consider the agreement to be confidential and submitted a copy to the Board under seal. UTU-IL contends that the agreement should be made available to the public. Applicants respond that a protective order was served December 9, 1996, to protect confidential and proprietary information produced in response to a discovery request. Applicants note that UTU-IL has not previously requested a copy of the agreement nor has it offered to sign the undertaking prescribed by the protective order.

The criticisms of UTU-IL are without merit. Applicants simply followed our rules in requesting that the agreement be held in confidence for legitimate business reasons. The dissemination of the terms and conditions which KCSI was willing to accept in order to acquire Gateway could operate to KCSI's disadvantage in future business negotiations. Moreover, if UTU-IL (or any other party) needed information in those agreements to present its case, the union could have signed the undertaking and received the agreement. The union did not do so and did not interpose any objection to the merits of the transaction.

UTU asserts further that KCSR's president, Mr. Michael R. Haverty, recently served as a director of Gateway, raising the question whether KCSR and Gateway may have already been under common control. Applicants respond that UTU-IL's assertions are unsupported. Applicants note that the Board's Secretary issued an informal opinion that KCSI was sufficiently insulated from premature control of Gateway under the voting trust arrangement. We agree with applicants. UTU-IL has not shown how representation by one seat on Gateway's board of directors would have enabled KCSR to control Gateway.

[4] KCSI also controls three non-operating motor carrier subsidiaries. In our decision served December 12, 1996, we granted applicants' request that these motor carrier subsidiaries not be considered "applicant carriers" under 49 CFR 1180.3(b) in this proceeding.

[5] *Kansas City Southern Industries, Inc., The Kansas City Southern Railway Company and K&M Newco, Inc. Inc.—Control—Midsouth Corporation, Midsouth Rail Corporation, Midlouisiana Rail Corporation, Southrail Corporation and Tennrail Corporation*, Finance Docket No. 32167 (ICC served June 4, 1993).

Meridan, MS, and with CSX Transportation, Inc. (CSXT) at Birmingham, AL. KCSR participates in movements of significant amounts of coal from the Powder River Basin to various electric utilities situated on its lines and hauls chemicals from the Gulf Coast region.

GWWR is a Class II rail common carrier operating approximately 461 miles of rail line between East St. Louis, IL, and Kansas City, KS, and branch lines to Springfield, IL, Jacksonville, IL, and Fulton, MO. GWWR also has haulage rights over UP between Springfield and Chicago, IL. GWWR operates a switching yard and various industrial tracks in Kansas City, KS, and provides service to owners of the Kansas City Terminal Railroad Company (KCT). GWWR's mainline between Godfrey and Church, IL, is jointly owned with SPCSL Corporation (SPCSL), a subsidiary of Union Pacific Corporation. In addition, in 1995, GWWR completed construction of a track connection in East St. Louis for direct interchange with CSXT and Consolidated Rail Corporation (Conrail).

Half of GWWR's revenue comes from performing haulage service for other carriers between Kansas City and East St. Louis. GWWR also provides switching service for other carriers in Kansas City and East St. Louis, IL.[6]

GWWR operates four scheduled road trains per day between Kansas City and East St. Louis, IL. GWWR also operates approximately 75 locals movements and 360 yard switch crews per month, depending on volume and service requirements. About half of the switch crews work in Kansas City, and the other half work in the East St. Louis yards. Local trains operate between Kansas City and Mexico, MO; between Mexico, MO, and Roodhouse, IL; between Roodhouse and Jacksonville, IL; between Roodhouse and Springfield, IL; and between East St. Louis and Roodhouse, IL.

GWER is a Class III carrier that is wholly owned by GWWR. GWER, which began operations in January 1994, owns and operates approximately 17 miles of track between East Alton, IL, and East St. Louis, IL. GWER is primarily engaged in industrial switching in the Alton and Wood River, IL areas. GWER now operates one round trip train five days per week between East Alton and East St. Louis, IL (Conrail's Rose Lake Yard). Extra trains are operated on an "as needed" basis. GWER's primary business is handling switch traffic to and from Conrail customers in the Alton area.

The Proposed Transaction

According to the application, KCSI entered into an agreement with Gateway and its parent, Gateway Management Partners, L.P., on February 28, 1996. Under the agreement, KCSI would assist Gateway and its parent to obtain a loan to refinance existing debt and additional operating capital. KCSI would also guarantee the repayment of the loan. The agreement also provided that, at the closing of the loan, Gateway would issue to KCSI a warrant entitling KCSI to acquire up to 90 per cent of Gateway's stock. The agreement further provided KCSI an option to purchase the remaining shares of Gateway's common stock. On November 22, 1996, KCSI assigned all of its right, title and interest under the agreement to KCSTC.

Applicants indicate that on December 12, 1996, KCSTC exercised the warrant and option, and acquired all of Gateway's outstanding common stock, depositing the shares into a voting trust. KCSI indicates that, after it obtains authority to control KCSR and Gateway, the voting trust will be dissolved and the trust stock will be distributed to KCSTC. Gateway then will become a wholly owned subsidiary of KCSTC. Through KCSTC, KCSI will obtain indirect control of Gateway and its wholly owned subsidiary GWER. Applicants indicate that Gateway will be marketed as part of the KCSR rail system, and that Gateway's operations will be coordinated with those of KCSR. GWWR and GWER will remain separate legal entities, however. KCSI says it has no present plans to merge Gateway into KCSR.

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[6] In 1996, GWWR entered into an agreement with KCSR to lease and operate a KCSR industrial switching line in Kansas City.

Applicants indicate that KCSTC acquired Gateway's stock for $10 million in cash. Additionally, KCSI has guaranteed a line of credit for Gateway of up to $40 million. Applicants expect that the transaction will increase KCSI's interest expenses slightly, but that the increase will not adversely affect KCSI's operations or financial position. Applicants indicate that KCSI's anticipated interest obligations will be well within the combined KCSR/Gateway system's income and cash flow, even before the additional earnings expected to be generated by common control are taken into consideration.

DISCUSSION AND CONCLUSIONS

Statutory criteria. Under 49 U.S.C. 11323(a)(2), the purchase by Class I rail carriers of property of another rail carrier requires prior approval.[7] The criteria for approval are set forth in section 11324. Because this transaction involves the merger or control of one Class I railroad but not of two or more Class I railroads, section 11324(d) governs. That section requires approval of the application unless the Board finds that:

(1) as a result of the transaction, there is likely to be a substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States; and

(2) the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs.

In transactions subject to section 11324(d), the primary focus is on the probable competitive effects. We must grant the application unless there will be adverse competitive impacts that are both "likely" and "substantial." Even then we may grant the application if the public interest benefit outweighs any anticompetitive impact that cannot be mitigated through conditions. *See Wilmington Terminal RR, Inc.--Pur. & Lease--CSX Transp., Inc.*, 6 I.C.C.2d 799, 803 (1990), and cases cited therein, 7 I.C.C.2d 60 (1990), *aff'd sub nom. Railway Labor Executives Ass'n v. ICC.*, 930 F.2d 511 (6th Cir. 1991) (*Wilmington Terminal*).

Competitive analysis. There is nothing in the record showing any anticompetitive effects from the transaction. Applicants submitted a competitive analysis from Dr. Curtis M. Grimm, who examined all origin-destination pairs in which KCSR and Gateway participate. He found that the common control of KCSR and Gateway would not result in a lessening of competition, the creation of a monopoly, or a restraint of trade in freight surface transportation in any region of the United States. Dr. Grimm concluded that the proposed common control of KCSR and Gateway is purely end-to-end and will result in no reduction of independent routing alternatives.

Applicants maintain that the combined KCSR/Gateway system will enable the carriers to provide more effective service to their customers and will permit them to compete better in the rail marketplace. They maintain that common control will also provide Gateway with financial security and afford the combined system significant opportunities to reduce expenses and rationalize operations. In their view, the proposed transaction will provide shippers and receivers with enhanced competition, better equipment utilization, improved car supply, improved plant maintenance, and other operating efficiencies.

In addition, applicants indicate that a combined KCSR/Gateway system will open new single-line routes for shippers, especially those shippers of traffic between the Southwest and the Northeast Corridor. They also maintain that the combined KCSR/Gateway system will facilitate routing of shipments directly through St. Louis to eastern destinations.

Moreover, applicants state that the combined KCSR/Gateway system will improve shippers' access to the important Mexico market and provide transportation options not currently being offered by competing rail systems. Finally, common control also will open up new marketing

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[7] Class II and Class III rail carriers may purchase rail lines under new 49 U.S.C. 10902.

opportunities for intermodal shippers. The addition of Gateway's routes to KCSR's intermodal network will provide intermodal shippers with access to additional intermodal lanes.

These claims by applicants are unopposed and unrebutted and, indeed, are supported by more than 30 shippers. Based on the record before us, we cannot find any likelihood that common control of these end-to-end systems will result in a reduction in competition in any market or that any customer will lose rail service or routing alternatives as a result of the transaction. Further, the transaction appears to offer the prospect of increases in competition, service, and operating efficiencies. Thus, no anticompetitive effects have been shown.

Public interest. The record also shows that there are substantial public benefits from the transaction. Applicants maintain that the proposed transaction will strengthen the combined KCSR/Gateway system and improve its operating and financial performance. Assertedly, KCSI's commitment to Gateway will provide it with the financial security and stability that it has not enjoyed in recent years. Applicants further maintain that common control also presents significant opportunities to reduce expenses and rationalize operations. They contend that the proposed transaction will improve the adequacy of transportation service to the public by offering new routing options and improving service to shippers and receivers on KCSR and Gateway lines. Assertedly, no customer will lose rail service as a result of the transaction. Allegedly, common control will have no adverse impact on the continuation of essential transportation services by KCSR, Gateway, or any other carrier, and will assure the preservation and continued viability of Gateway's lines.

Applicants assert that they expect only minimal operating changes due to common control of KCSR and Gateway. According to applicants, all road trains and locals currently operating will continue as they are with no significant changes. They indicate that the small amount of additional interchange traffic expected to occur between KCSR and Gateway in Kansas City will be handled with existing capacity on switch engines and road trains.

The transaction is not expected to have any adverse impact on commuter or other passenger service. The Amtrak trains that operate over Gateway's trackage will not be affected by this transaction. Only small amounts of additional traffic are expected to be generated between KCSR and Gateway, and this traffic is not expected to significantly impact the number of freight trains using joint freight/passenger trackage.

Applicants anticipate that the common control of KCSR and Gateway will result in an increase of approximately 3,633 carloads diverted to the combined KCSR/Gateway system. According to a verified statement of Michael H. Rogers, some of the new traffic will be derived from extensions of haul on existing KCSR and/or Gateway traffic. Other new traffic will be diverted from other carriers or from markets in which neither KCSR nor Gateway currently participates. Much of this traffic is estimated to be generated through St. Louis. The increased traffic is expected to generate additional annual revenues of approximately $5 million.

Applicants expect that the proposed transaction will save them approximately $1.5 million annually in operating expenses. They note that, since 1995, Gateway and KCSR either have entered into or are in the process of negotiating and putting into place a number of arrangements for sharing resources, resulting in mutual operating savings. Assertedly, the parties are negotiating the relocation of Gateway's intermodal operations at Kansas City to KCSR's facility. In addition, the applicants entered into an agreement on April 1, 1996, in which KCSR granted Gateway a license to use software developed by KCSR that provides computerized record maintenance, billing, car tracing, and interline revenue accounting. This will enable Gateway to report its waybill data to the Association of American Railroads (AAR). Under that agreement, KCSR will provide Gateway with technical assistance in acquiring and setting up the hardware necessary to operate the system. This computerized system will be of significant benefit to Gateway in its future record-keeping, billing, and car tracing processes and participation in AAR-mandated initiatives.

Additionally, applicants expect to save approximately $1 million a year by eliminating duplicate facilities and functions, such as office rent, various professional functions, outside legal and accounting expenses, and property and liability insurance expense. Applicants indicate that they are also considering the consolidation of dispatching and shop facilities.

Applicants anticipate that consolidating Gateway's car fleet with KCSR's car fleet will reduce the short-term lease expense for various car types, resulting in estimated annual savings of $50,000. In addition, use of more reliable, higher horsepower locomotives, and implementation of improved maintenance-of-way operations on Gateway's lines, is expected to improve overall transit times. Enhanced transit times are expected to generate approximately $220,000 in annual operating savings from improved utilization of the combined system's car fleet and reduction in car hire expenses on foreign line equipment.

KCSR will make its work equipment available under contract to maintain Gateway's tracks and facilities, enabling Gateway to retire and sell older and less reliable equipment. In addition, applicants state that by combining the purchasing functions and volume requirements of both carriers, materials will be available to Gateway at lower costs.

Applicants also expect to realize savings by better use of locomotive fleets. Currently, KCSR has 18 locomotive units in storage. If KCSR and Gateway come under common control, some of these stored units will be placed back into service. This would allow 4 units currently leased by Gateway to be returned to lessors, resulting in rental savings. According to applicants, returning one of these leased locomotives would result in initial annual savings of approximately $31,025. Gateway's remaining leased locomotives are leased through the year 2001. When the leases expire and the units are returned to lessors, applicants expect additional annual savings of approximately $142,350. Applicants expect to realize one-time savings due to reduced locomotive and freight car parts inventories, retirement of unused yard and side tracks, acceleration of scrap recovery, and sale of surplus locomotives.

Based on the evidence before us, we conclude that this transaction not only lacks anticompetitive effects but also shows prospects of significant public benefits.

Labor protection. Applicants state that they do not expect any existing nonexempt KCSR or Gateway employees to be adversely affected by the transaction. They indicate that Gateway's nonmanagement employees and maintenance of way employees are represented by national unions and covered under existing collective bargaining agreements. These agreements will remain in force. Applicants state that there are no plans to transfer work currently performed by Gateway employees to KCSR locations. They also report that management personnel on Gateway and exempt personnel on GWER are not covered by collective bargaining agreements.

Under 49 U.S.C. 11326(a), with exceptions not pertinent here, when approval is sought for a transaction under sections 11324 and 11325, the imposition of labor protection is mandatory. In the absence of a need for greater protection, the conditions in *New York Dock Ry.—Control—Brooklyn Eastern Dist.*, 360 I.C.C. 60 (1979) are appropriate for this type of transaction. Because no need for greater protection has been shown, these conditions will be imposed here. This is consistent with requests of applicants and rail labor.

Environmental issues. Applicants state that, under 49 CFR 1105.6(c)(2)(i), the proposed control transaction is exempt from environmental reporting requirements and that, under 49 CFR 1105.8(b)(1) and (3), it is exempt from historic preservation reporting requirements. The Board's Section of Environmental Analysis has reviewed the application and agrees with applicants. Accordingly, we conclude that the proposed transaction will not significantly affect either the quality of the human environment or the conservation of energy resources and will have no effect on historic properties.

As noted in the notice served February 13, 1997, applicants requested that the proceeding be expedited. We will accommodate the request and make the decision effective May 5, 1997.

Based on the record, we find:

1. The proposed control transaction will not substantially lessen competition, create a monopoly, or restrain trade in freight surface transportation in any region of the United States.

2. This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. The application under 49 U.S.C. 11323, *et seq.*, for KCSI to acquire control of GWWR and GWER is approved, subject to the employee protection conditions described in *New York Dock Ry.—Control—Brooklyn Eastern Dist.*, 360 I.C.C. 60 (1979).

2. This decision is effective on May 5, 1997.

By the Board, Chairman Morgan and Vice Chairman Owen.

Vernon A. Williams
Secretary