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August 25, 2014

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ENTERED
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VIA E-FILING

Cynthia T. Brown, Chief
Section of Administration, Office of Proceedings
Surface Transportation Board
395 E Street, SW
Washington DC 20423-0001

Re: STB Ex Parte No. 665 (Sub-No. 1)
Rail Transportation of Grain, Rate Regulation Review

Dear Ms. Brown:

Pursuant to the Surface Transportation Board's decision served on April 18, 2014 in the above captioned proceeding, enclosed, via e-filing, are the Reply Comments Of The Kansas City Southern Railway Company ("KCSRR") to be filed in the above captioned matter. If there are any questions concerning this filing, please contact me by telephone at (202) 663-7823 or by e-mail at wmullins@bakerandmiller.com.

Sincerely,

William A. Mullins

Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 665 (SUB-NO. 1)

RAIL TRANSPORTATION OF GRAIN,
RATE REGULATION REVIEW

REPLY COMMENTS OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY

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Attorneys for The Kansas City Southern Railway Company

Dated: August 25, 2014

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 665 (SUB-NO. 1)

RAIL TRANSPORTATION OF GRAIN,
RATE REGULATION REVIEW

REPLY COMMENTS OF
THE KANSAS CITY SOUTHERN RAILWAY COMPANY

On December 12, 2013, the STB issued a decision soliciting comments from the public on how to ensure the Board's rate complaint procedures are accessible to grain shippers, and whether those procedures provide effective protection against unreasonable freight rail transportation rates.[1] The Kansas City Southern Railway Company ("KCSR") did not submit initial comments, but submits these brief reply comments responding to the National Grain and Feed Association's ("NGFA's"), offhand suggestion in a footnote that KCSR's revenue adequacy be assessed at the holding company level, so as to include the revenues of KCSR's affiliate Kansas City Southern de Mexico, S.A. de C.V. ("KCSM") in the determination.

Summary. NGFA's suggestion that KCSM revenues should be included in determining whether KCSR is revenue adequate is misplaced and should not be adopted. NGFA's suggestion is made in the wrong proceeding; is based on incomplete and mistaken assertions of fact; and would not lead to a more accurate picture of the financial health of entities that the Board regulates.

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[1] The procedural schedule in that decision called for comments to be due by March 12, 2014, and replies to be due by May 12, 2014. By decisions served on February 10, 2014 and April 18, 2014, the Board modified the procedural schedule for filing comments and replies. Comments were filed on June 26. Replies are due today, August 25, 2014.

Background.

NGFA's June 26 comments ("NGFA Comments") call, in part, for a revision to the Board's methodology for determining revenue adequacy. In particular, NGFA claims that the current STB formula for determining the revenue adequacy of Class I railroads with affiliates outside the U.S. is flawed and not representative of the true financial health of those Class I railroads. To remedy this alleged flaw, NGFA calls, in part, for determining revenue adequacy based upon the revenues of the parent companies of U.S. Class 1 railroads, including revenues of their foreign railroad subsidiaries and all other, related companies, rather than just their U.S. rail operating subsidiaries.[2]

The NGFA Comments mainly focus on including the Canadian operations, not just the U.S. operations, of the Canadian carriers. However, Mr. Fapp's verified statement, in a footnote, also used Kansas City Southern ("KCS"), the parent company of KCSR, as an example:

> "The KCS is another unique case. Like CN and CP, the KCS has extensive rail operations in another country, in this case Mexico through its Kansas City Southern de Mexico subsidiary. When viewed as a whole, KCS's ROI in 2011and 2012 was 11.35 percent and 10.93 percent, respectively. In both years, the KCS's ROI as a whole was higher than the ROI for KCS's U.S. subsidiary."[3]

Discussion.

NGFA's argument is misplaced, made in the wrong proceeding. NGFA even acknowledges[4] that the Board is conducting a separate proceeding on its revenue adequacy standards,[5] and that this is the wrong proceeding in which to consider suggested revisions to the revenue adequacy standards. Indeed, NGFA says, "NGFA is not, in this Opening, proposing any specific changes to the

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[2] NGFA Comments, Verified Statement of Daniel L. Fapp, Vice President, L.E. Peabody & Associates, Inc. ("V.S. Fapp").

[3] Id., V.S. Fapp at 18, n. 26.

[4] See NGFA Comments at 23.

[5] Railroad Revenue Adequacy, EP 722 (STB served April 2, 2014).

Board's current methodology for determining railroad revenue adequacy." Nevertheless, NGFA submits several pages of argument and an entire verified statement doing just that.

Such argument is misplaced. If it had any merit at all - which it does not - it should be submitted in the Board's Ex Parte 722 proceeding. The Board's notice in this proceeding does not include this issue, and it would be improper to consider it here.[6]

In addition, NGFA's argument is based on mistaken and incomplete assertions of fact. In essence, Mr. Fapp's verified statement is intended to argue that railroads subject to the Board's jurisdiction are parts of large corporations. Those corporations, Mr. Fapp contends, divide their corporate structures into multiple subsidiaries, disguising their overall Return on Investment ("ROI"). Mr. Fapp spends pages expounding on his beliefs as to why corporations have subsidiaries, and why those legal structures should be ignored by the Board in determining revenue adequacy.

Mr. Fapp's statement is incorrect in some respects. For example, Mr. Fapp presents his Table 2 on page 8 of his verified statement, purportedly listing, "Number of Reporting Subsidiaries for Class I Railroads," based on 2013 R-1 Annual Reports. For KCSR, the table shows the number of subsidiaries to be 6, matching the number of companies listed on page 4 KCSR's R-1 for 2013. In fact, however, only 1 of those 6 companies listed on page 4 KCSR's R-1 for 2013 - Gateway Eastern Railway Company - is a subsidiary of KCSR. The other five, which include one non-wholly-owned affiliate and two companies which are not railroads, are indirect subsidiaries of KCS, but not of KCSR. To what extent similar things can be said about the other Class I railroads listed in the table, each of which have many more "subsidiaries" than are listed for KCSR, is unknown.

Mr. Fapp's statement also omits important reasons why railroads have multiple affiliates, some in other countries. As the Board knows, KCSM was until about ten years ago majority-owned by a Mexican company that was not affiliated with KCS. Such ownership was required in order for

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[6] See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29 (U.S. 1983).

the company that is now KCSM to bid for a concession from the Mexican government to operate rail lines owned by the Mexican government. Those rail lines are solely in Mexico, and continue to be owned by the Mexican government but operated by KCSM. These historic and structural reasons, along with others, are not mentioned by Mr. Fapp as they would undercut his argument that legal structures and international boundaries should be ignored.

Mr. Fapp's argument also asserts that U.S. railroads are more revenue adequate than the Board determines, and at this point in history, the Board should be assessing profitability at the holding company level. Of course such an argument serves his purpose at this time. Undoubtedly, if the railroads subject to the Board's jurisdiction had a higher ROI than the overall corporate families of which they were a part, NGFA would not be making these arguments. The argument is results-oriented, not based upon sound policy that complies with the law.

Finally, NGFA's argument does not comply with the law. ICCTA's revenue adequacy provision clearly states that it applies only to companies subject to the Board's regulation:

> The Board shall maintain and revise as necessary standards and procedures for establishing revenue levels <u>for rail carriers providing transportation subject to its jurisdiction under this part</u> that are adequate, under honest, economical, and efficient management, to cover total operating expenses, including depreciation and obsolescence, plus a reasonable and economic profit or return (or both) on capital employed in the business. The Board shall make an adequate and continuing effort to assist those carriers in attaining revenue levels prescribed under this paragraph.

49 U.S.C. Section 10704(a)(2) (emphasis added). KCSM is not subject to the Board's regulation. KCSM does not operate within the United States, and is subject to the laws of Mexico - regulatory laws, tax laws, customs laws and others - not to the laws of the United States, including ICCTA.[7]

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[7] The Board does not have jurisdiction over the operations or regulations of foreign rail carriers. 49 U.S.C. §10501(a)(2); See, e.g., Canada Packers, Ltd. v. Atchison, Topeka & Santa Fe Railway Co., et al., 385 U.S. 182 (1966); Anderson, Clayton & Co. v. Southern Pacific Company, 349 I.C.C. 335, 1965 ICC LEXIS 1 at *6, n.3 ("Congress could not confer upon this Commission jurisdiction with respect to transportation in a foreign country."); Great Northern R. Co. v. Sullivan, 294 U.S. 458

Thus, NGFA's suggestion to include the revenues of KCSM in assessing the revenue adequacy of KCSR conflicts directly with the Board's governing statute.

Conclusion.

NGFA's suggestion that KCSM revenues should be included in determining whether KCSR is revenue adequate is misplaced and misguided. The suggestion is made in the wrong proceeding, based on incomplete assertions of "fact," and is contrary to the Board's governing statute. NGFA's suggestion should not be adopted by the Board, in this or in any other proceeding.

Respectfully submitted

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Dated: August 25, 2014

(1935); Lewis-Simas-Jones Co. v. Southern Pacific Co., 283 U.S. 654 (1931); News Syndicate Co. v. New York Central R. Co., 275 U.S. 179 (1927).